

THE INDONESIAN QUARTERLY

VOL. XVI, NO. 4, 1988:

Current Events

Indonesia's Economic Development:
Recovery after Deregulation

Performance of Indonesia's Agriculture:
Food Self-sufficiency and Beyond

Employment in Indonesia in Pelita V

The Big Powers in Southeast Asia in the 1990's:
Their Interests and Roles

Indonesia-Malaysia Bilateral Relations

Book Reviews



THE INDONESIAN QUARTERLY

CENTRE FOR STRATEGIC AND INTERNATIONAL STUDIES

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ERRATA

The Indonesian Quarterly, Vol. XVI, No. 4, October 1988

1. On page 407, the last sentence of the first paragraph:

However, the high priority attached to the production of rice is believed to have created the achievement of the objective of food diversification programmes.

should be read

However, the high priority attached to the production of rice is believed to have *created difficulties in achieving* the objective of food diversification programmes.

2. On page 412, the 3rd. line of the last paragraph:

Rural farm ...

should be read

Rural off-farm ...

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From the Editor

The Editor's wish to publish articles on the conditions and environments in which Indonesia will have to continue its economic development is, to some extent, fulfilled in this October 1988 issue of the Quarterly. To his regret, though, it comes out very late.

The reader will find an overall analysis of the country's economic development in "Indonesia's Economic Development: Recovery after Deregulation," in which Djisman S. Simandjuntak probes into the next five years after discussing Indonesia's performance in overcoming difficulties during the Fourth Five Year Development Plan (Pelita IV), which will end on March 31 1989.

Indonesia's performance in self-sufficiency in rice, which the government rightfully takes pride in, is scrutinised by I. Tubagus Ferry in "Performance of Indonesia's Agriculture: Food Self-sufficiency and Beyond," in which he attempts to identify the problems that would be faced by the country when it pursues further food self-sufficiency in the years to come.

As unemployment and underemployment continue to cause concern in Indonesia as it approaches the launching of Pelita V, April 1 1989, the problem is discussed by Aries Ananta in "Employment in Indonesia in Pelita V" through an analysis that relates certain demographic changes to economic growth.

The security and stability needed by the countries in Southeast Asia to have a favourable environment for developing economic welfare is partly determined by the interplay among major powers in this part of the globe. J. Soe-

djati Djiwandono's article, "The Big Powers in Southeast Asia in the 1990's: Their Interests and Roles," attempts to understand one major aspect of Indonesia's security environment.

Indonesia and other countries in Southeast Asia have enjoyed a secure and stable environment thanks, to a large extent, to the warm relationship that has developed between Indonesia and Malaysia since 1966, that watershed that saw at the same time the advent of Indonesia's New Order and the ending of the konfrontasi (confrontation) that had severely strained the relationship between the two countries. Yet, as assumptions may, over time, lose validity, Jusuf Wanandi suggests in "Indonesia-Malaysia Bilateral Relations" that certain assumptions that have served as foundations for the close relationship be continuously re-examined and new grounds for close co-operation be identified.

Kajat HARTOYO

Current Events

Indonesia's Banking System Deregulated

A package of deregulatory measures -- the first of a series of four that will liberalise further the Indonesian economy -- was announced on October 27 1988 by the government.

By far more comprehensive than the June 1983 package which gave some freedom to state-owned banks, it eases restrictions affecting Indonesia's financial system, particularly banks and non-bank financial institutions. The three other packages, which apparently will ease regulations on the manufacturing sector, investments and state-owned enterprises are expected to come within the two remaining months of the year.

The October 1988 package is expected to result in: (a) the increase of domestic savings through the banking system, which includes non-bank financial institutions; (b) the increase of non-oil exports; (c) the enhancement of efficiency in the banks and non-bank financial institutions; (d) the improvement of policy instruments for the effective implementation of monetary policies; and (e) a spur to the now small capital and stock market to grow.

Most observers hail the long awaited step, although some also caution against its eventual destabilising effect on the monetary situation. In fact, if properly implemented, the deregulatory package will create a competitive atmosphere that will leave no room to banks and non-bank financial institutions that fail to offer competitive services.

A summary giving the essentials contained in the deregulatory measure will be followed in this brief essay by a preliminary evaluation.

The Essentials

Comprised in 17 decrees, the gist of the package includes the following:

1. Foreign banks now operating in Jakarta and having sound records and capital base are allowed to open sub-branch offices in seven major cities, namely Jakarta, Medan, Bandung, Semarang, Surabaya, Denpasar and Ujung Pandang, but 50 per cent of the lendings the new sub-branch offices provide during the first twelve months must be used for financing exports.
2. Banks having a representative office in Jakarta and listed as major banks in their home countries are allowed to set up banking joint ventures with domestic banks in the aforementioned seven major cities, on the condition that:
 - a. The new joint-venture bank has a paid up capital of Rp 50 billion (US\$29.2 million), of which at least 15 per cent is owned by the domestic bank and the part owned by the foreign partner does not exceed 85 per cent.
 - b. The domestic partner(s) has sound capital base and operational records during the last 24 months.
 - c. The percentage of export credits in the loan portfolio of the joint venture bank will have reached at least 50 per cent of its credit facilities, 12 months after its establishment.
3. Restrictions on the opening of branches and sub-branches by all domestic banks with sound operational records and capital bases during the 24 months prior to the application of opening them shall be eased and any licence requirement for sub-branches shall be eliminated.
4. Non-Bank Financial Institutions (LKBB) having sound operational records and capital bases for the last 24 months are allowed to open branch offices in Jakarta, Bandung, Semarang, Surabaya, Medan, Ujung Pandang and Denpasar. The LKBBs are also allowed to issue Deposit Certificates, which were not allowed before, without prior permission from the Department of Finance or Bank Indonesia.
5. New Private, Co-operative and Development Banks may be set up under the condition that they have a minimum of Rp 10 billion paid up capital. They are also allowed to issue deposit certificates without prior approval

by the monetary authority.

6. All banks -- instead of only state-owned and selected private banks -- are permitted to participate in the time deposits and other savings programmes.
7. The conditions to become Foreign Exchange Banks are relaxed, by requiring only that:
 - a. the bank concerned must be considered healthy over the last 24 months;
 - b. the volume of activities must at least amount to Rp 100 billion in turn-overs.
8. Branches of national banks previously requiring a permit from Bank Indonesia are now allowed to function as foreign exchange banks. Those banks are required only to report to the Department of Finance and Bank Indonesia.
9. The SWAP mechanism is improved through the following:
 - a. The time limit of SWAP is extended from a maximum of six months to three years;
 - b. The SWAP premium is based on the market situation, namely the difference between the average domestic deposit rate and LIBOR (London Inter-bank Offered Rate).
 - c. Whenever a bank demands a higher premium, the subsequent SWAP premium from Bank Indonesia will be adjusted to that premium (e.g. If the average rate of a six-month time deposit, as per September 30 1988 is 17 per cent, and the US Dollar LIBOR rate for 6 months, as per September 30 1988 is 9 per cent, the difference -- amounting to 8 per cent -- is the premium level of the SWAP).
10. Operating licences for money changers that was previously only valid for one year, is changed into permit without time limit, though it can be revoked when violations occur. In addition to non-foreign exchange banks, which are allowed to trade foreign exchange, money changers' activities also include the selling and buying of foreign bank notes, coins and traveller's cheques.
11. Funds of Non-Banking State-owned Companies (BUMN) and Regional State-owned Companies (BUMD) in private banks and non-bank financial institutions with the following conditions:
 - a. the placement of funds in a general bank, development bank shall not exceed 50 per cent of the total funds placed;

- b. the funds placed in any single private bank shall not exceed 20 per cent of the funds placed by a non-banking state-owned company.
12. The mandatory minimum reserve for banks is lowered from 15 per cent to 2 per cent of the total obligations to third parties (giro, deposits and savings). This also applies to non-bank financial institutions (LKBB).
13. Banks and non-bank financial institutions (LKBB) will be given a maximum legal lending limit to their respective borrowers, as well as shareholders and the Board, which is as follows:
- a. 20 per cent of the bank's own capital or that of the LKBBs, for the facility provided to one lender;
 - b. 50 per cent of the bank's or the LKBBs' own capital provided to one group of lenders;
 - c. 5 per cent of the bank's or LKBB's own capital for a member of the Board of Commissioners (non-shareholders) or group of companies he owns;
 - d. 10 per cent of the total of participation at the bank or LKBB, for a credit facility provided to a shareholder and the group of companies he owns;
 - e. 25 per cent of the participation at the bank or LKBB, for a credit facility provided to a shareholder and the group of companies he owns;
 - f. The amount of the salary or monetary remuneration return capacity of the lender to be paid by the bank or LKBB concerned, in case one is a member of the Executive Board or Personnel.
14. Money market securities, namely General Bank Certificates (SBPU) and Bank Indonesia Certificates (SBI), which in the past were valid for only seven days, are now valid for six months; and the auction of Bank Indonesia Certificates (SBI), which was only executed whenever necessary in the past, will take place as a daily auction, and will have an additional permanent weekly auction. In addition, the ceiling of interbank loans (15 per cent of the third party's funds) is abolished.
15. Tax is levied on income derived from Time Deposits, Deposit Certificates and Savings at a fixed rate of 15 per cent, with the levy to be collected by the bank and to be transferred to the state treasury without any fiscal inquiries about the source or origin of time deposits and permanent savings. Income tax shall not be levied on revenues derived from interest on Tabanas/Taska (Savings Deposit/Insurance Savings Deposit), Simpedes (Village Savings), TUM-KPR (Savings/down payment on house ownership), ONH (Haj Pilgrimage Savings) and other minor savings.

Preliminary Evaluation

The deregulation package in the financial, monetary and banking sectors is quite comprehensive as aforementioned. However, it still remains to be seen how the measure is implemented. The government's control over the whole process of implementing the package will become a crucial factor in bringing it into effect.

Hence one may infer that at least one immediate impact of the new move is a likely increased competition within the banking industry, which is currently dominated by state commercial banks. Prior to the deregulation package a quite substantial share of credits in Rupiah and foreign exchange was contributed by the state banks. Furthermore, the relaxation of restrictions on foreign bank operations, the reopening of the banking industry, the facilitations to open branch and sub-branch offices will give a boost to competition. As is wellknown, a heightened competition will not only improve efficiency -- for example, by reducing the costs of loan funds for the business sector -- but will also force banks to become more aggressive and innovative in offering loans of financing packages and saving schemes to borrowers and depositors.

Considering the complexity in business activities and the wide variety of business opportunities in Indonesia in the last few years, and in view of the widely changing economic situation, banks are required not only to perform as financial intermediators and lenders but also as business consultants capable of advising businessmen on new viable ventures and to offer attractive financial packages for such undertakings.

Prior to the enactment of this deregulation package, domestic banks generally had poor consulting capabilities, especially state banks, whereas on the other hand, foreign banks were restricted in performing their consulting functions. One may expect that the opportunity given to foreign banks to operate in the aforementioned seven major cities and to national banks to set up joint ventures with foreign banks will consequently spark the development of the banking industry and a wider range of services to the business sector.

One of the major issues regarding the operating activities of banks; which have given cause to concerns among some people in this country, especially in the last few years, is that some banks provided credits only (mainly) to certain companies or people (e.g. shareholders, members of the board). Some people worry that these activities will not improve efficiency but create unfair competitions instead. To create a more favourable climate, banks as well as non-

banking financial institutions will be given a maximum legal lending limit of the loans they can make to individuals or group of borrowers, including the shareholders and the board. Here, again, it remains to be seen how the regulations are implemented and how the government is able to control the activities of the banks and their borrowers.

Relaxation of the requirement that allow state-owned enterprises (BUMN) and regional state-owned companies to shift up to 50 per cent of their deposits from state-owned to foreign or domestic private banks may contribute in creating fairer competition within the banking industry. In May 1988, for example, time deposits of state-owned enterprises at state banks amounted to Rp 2,247.6 billion (about 21.53 per cent of the total outstanding Rupiah time deposits with state banks) and during the same time the total amount of outstanding bank credits in Rupiah by state banks was Rp 23,532 billion, and the total amount of outstanding bank credits in Rupiah by Private National Commercial and Foreign banks was Rp 8,476 and Rp 1,276 billion respectively. Judging from this data one may assume that after the enactment of this new regulation the non-state and private banks may also enjoy the (cheap) funds derived from state companies. However, this relaxation measure is still questionable since private banks -- as experience has shown -- are sensitive to speculative activities especially when the economy is facing a difficult time. Soon after the 1986 devaluation, for example, a state owned bank reaped benefits by speculating or by buying up foreign exchange, regardless the regulations.

The decision of the government to impose tax on income derived from time deposits, deposit certificates and savings at a fixed rate of 15 per cent as of November 19 1988 is a bold one indeed. A few months ago, the widely publicised debates on the need to impose tax on income derived from time deposits attracted the full attention of the public. Those who favoured imposing the tax argued that it was the right time to impose tax on income derived from time deposits in view of the difficulties faced by the government in increasing her revenue (mainly caused by the drop of oil prices), of creating more justice in the sharing of the burden of development and of invigorating the capital market. Those who were against this move argued that the decision could destabilise the monetary situation and lead to capital flight. On the other hand, they argued, the government's income derived from tax on income of time deposits would not be sufficiently big (it would only amount to about less than Rp 500 million a year), and in order to invigorate the capital market a number of moves could be taken or implemented rather than to impose tax on income derived from time deposit interests.

Accordingly, the decision to impose tax on income derived from interest of time deposits will in the short term likely force the banking industry to temporarily raise their deposit rates, not because of an increase in the cost of money (one has to keep in mind that the minimum reserve requirement has been reduced from 15 per cent to 2 per cent), but rather to create a cushion for the psychological impact of the measure and to dampen the possibility of capital flight. Experience has shown that in order to avoid capital flight and to increase deposits from the public, Indonesia always contends that net income from deposits will be higher if the depositors put their money in Rupiah rather than in foreign exchange. However, since there is no guarantee for the rate of exchange of the Rupiah against foreign currencies and the different rates of inflation between Indonesia and the outside world, it is very difficult to assure that capital flight will not occur, especially immediately after the regulations come into effect. Hence it has become obvious that Indonesia's capability in maintaining a low inflation rate, offering attractive interest rates, avoiding depreciation of the Rupiah and creating a favourable business climate will influence potential depositors as to whether to keep their funds at domestic banks or to park them abroad.

However, the government's decision to uphold the banking secrecy of deposit owners and to continue to refrain from investigating the source or origin of the deposits would constitute a factor that absorbs the eventual grave repercussions.

Some observers believe that the levying of tax at a final rate of 15 per cent on income derived from time deposit interests will equate the tax treatment for both the short-term money and stock markets, which will consequently invigorate the capital market. The equal tax treatment is expected to facilitate the operations of the Second Section (parallel market) on Jakarta's "stock exchange" which should have originally started as of April 1988.

However, considering past experiences it remains questionable whether the market will develop as expected. It seems that the general public's hesitation to put their money in it is due to the fact that they are not as yet ready to bear risks.

The aforementioned reform measures will indeed, step up the efficiency of the banking sector and capital market in mobilising and operating the available funds and concurrently stimulate a more efficient allotment of financial resources to productive sectors. Nevertheless, to avoid failure in achieving

the optimum results, attention has to be paid to control. Above all, the government needs to avoid every unnecessary delay caused by bureaucratic red tapes and to prevent the mishandling of their implementation.

Pande Radja SILALAH

Indonesia's Energy Problem: The Unviability of "Historical Trends"

At present the electrical power grids in Indonesia have a capacity of 4,000 MWe. Data show that the sale of electricity by the state-owned Electricity Company increases at an average rate of 15-20 per cent per year, except in 1984, when the rate was only 10 per cent. Thus there is a doubling of electricity consumption every 5 to 6 years. By almost anybody's standard, this is a very fast growth. Yet, despite the government programme of rural electrification, only 15 to 16 per cent of the households enjoy electricity.

There are two projections of electricity demand for the year 2000. One of them, done by the State Electricity Company in collaboration with the World Bank, gives a projected power requirement of 18,876 MWe. The other projection was arrived at by the National Atomic Energy Commission. Originally it quoted a projected electricity demand of 25,000 MWe, but this was later reduced to a more conservative growth rate of 10 per cent annually until the year 2000, yielding a need of about 10,000 MWe by then. Of this, 80 per cent will supply Java, while the other 20 per cent will serve the rest of Indonesia.

So far, there are no interconnected grids, except in Java. Outside Java, electricity is generated in small and medium-sized diesel-fueled plants. The recently built big, hydropower plant "Sigura-gura" in North Sumatra has almost all of its output channelled to INALUM, a Japanese-Indonesian joint-venture aluminium smelting mill.

Java is now populated by about 100 million people. The power supply for this densely populated island is generated in the "Suralaya" coal-fueled power station (800 MWe) and in oil-fueled power station plants (1,000 MWe), the rest

comes from hydropower generators. The potential hydropower in Java is being rapidly depleted, the exploitation of the remaining 1,600 MWe is being worked out even now. It is true that Java also has a reserve of about 4,000-5,000 MWe from geothermal, but its exploitation will require huge capital and will take a long time to implement it. Up to now only 30 MWe of geothermal power has been tapped.

To meet the demand of electricity in Java there are only a few alternatives left, namely oil, gas, coal, and nuclear. However, both oil and gas are becoming scarce as they become export commodities to earn the much needed foreign exchange. At the present rate of growth of domestic oil consumption, i.e., 14 per cent, there will be little oil left for export in 20-30 years to come. Indonesia also has coal in Sumatra and Kalimantan, the mines however are located no less than 400 km away from the sea-shore. This entails a big consequence on the difficulty and cost of transporting the coal to Java. Moreover, the price of coal increases about 4.6 per cent per year, and the domestic component in the construction of coal-fueled power stations, which is 35 per cent, is only 4 per cent higher than that in the construction of nuclear power stations.

Based on the above considerations, the proponents of nuclear power want to build nuclear power stations to supply 40 per cent of the peak load, will be about 4,000 MWe in the year 2000. Realising that Indonesia is plagued with economic problems, with a DSR of over 40 per cent, however, they think that 1,000 MWe from nuclear is more realistic. Indonesia has uranium deposits. The mining of the ore and part of the fabrication of its fuel elements can be done in Indonesia by Indonesian technologists. Only the enrichment, and the recycling of the spent elements, if the fuel is to be recycled at all, instead of being dumped in a "safe" burial site, will have to be done in a foreign country.

The opponents of nuclear power argue that the cost of building a nuclear power station is prohibitively huge and, worse than that, unpredictable. The figure quoted by Bechtel was US\$1,065/kWe in July 1985, which will most probably greatly increase by the time the construction is started. And then there are the problems of waste disposal and the cost of decommissioning the plants, later. Opponents also doubt that Indonesian technologists are really ready to handle this piece of high technology. They also fear of the first reactor tending to be followed by more reactors before the nuclear people have the chance to learn how to deal with safety issues.

Lack of Participation

Indonesia bears a heavy burden of foreign debt. OPEC, of which Indonesia is a member, has not been able to keep the price of oil from plummeting. Non-oil and gas commodities cannot compete in the world market, due to: (1) their quality and/or workmanship which are not at par with the same products from the NICs; (2) the productivity of Indonesia's workforce is low; and (3) the high-cost economy, stemming from inefficiency and the snarl of red tapes, makes the price of non-oil/gas commodities not competitive.

Indonesia also has a grave population problem, with a population of over 170 million and which is still growing at a rate of 2.34 per cent. The fact that about 100 million of the people live in Java, an island only 6 per cent of the total size of Indonesia, certainly does not help ease the burden. For a few years to come, it remains to be seen whether the deregulation will be sufficient to push the economy to growth over the current level of 3 per cent. The DSR stands now at an alarming level of over 40 per cent.

It is therefore questionable whether Indonesia can really afford to buy a sizeable nuclear power station. Such a station would cost the country a few billion dollars, especially if problems and delays make the lead time longer than normal, with correspondingly high cost over-runs, as one would expect considering the experience of other developing countries that have gone nuclear.

Besides, there are a whole range of questions, such as whether there ever exists a reactor design that is truly "safe," whether Indonesian technologists are really ready to handle such a piece of highly-complicated technology, whether the energy projections are accurate and point to an energy requirement which is sufficiently high to warrant electricity generation by a nuclear power station, whether Indonesia's interconnected electrical power grids are reliable to absorb and distribute certain, large percentage of the total peak power, etc.

Nevertheless, the government, i.e., the Office of the State Minister for Research and Technology and the Department of Mining and Energy, has made the decision to go nuclear. The site has been picked; it is at the foot of the extinct Mount Muria, in the north-eastern tip of Java where, according to the proponents of nuclear generated electricity, the terrain is geologically stable.

If, for the purpose of looking at the balance of "going" versus "not going" nuclear, Indonesia is represented by four groups, the picture figures as follows:

- a. First, there is the majority: the socio-economically low stratum of the society. Ignorance prevents them from stating their anti-nuclear stance. However, their fear of nuclear power is beginning to emerge. A survey conducted by the Indonesian Environmental Forum (WALHI) on the opinion of the people living at the foot of Mount Muria, especially in the village of Ujung Watu and its vicinity, of those living around the Serpong area, where a 30 MWe MZFR is operating, and those living around the side of the "Kartini" reactor, a trige-mark-type reactor built by Indonesian technologists from parts cannibalised from an old reactor of the same type, in Yogyakarta.
- b. Second, the middle class, including the scientists. The "pro"- "con" ratio in this group is about 35:65 in favour of those "against" going nuclear. This estimate is arrived at from data garnered by WALHI from discussions, interviews and the monitoring of papers in journals and articles in the press.
- c. Third, the decision-makers. These are the Department of Mining and Energy, the Office of the State Minister for Research and Technology (one of the far-reaching arms of which is the Institute for Technology Studies and Application), the State-Owned Electricity Company, and the Department of Public Works. They are of the opinion that the decision on the nuclear power plant be put off, pending further studies into the economics and its safety issues. The only two institutions which are entirely sure to go all the way for one or two first power reactors are the Agency for Technology Studies and Application and the National Atomic Energy Commission. A minority though, these two are in this group, and they seem to be in the best position to influence the final decision.
- d. Fourth, the NGOs. Out of the 150 NGOs surveyed by WALHI, 71 responded. Of these, 63 are "against" nuclear power, 1 "for," and 7 "abstain."

The Indonesian Environmental Forum, which seems to enjoy good relations with the Office of the State Minister for Population and the Environment, is of the opinion that an open debate can be initiated for the last three groups. As far as the first group is concerned, while it would be unrealistic to open such a forum, an avenue is left open to this seemingly ignorant mass, that is, the mobilisation of legal-aid bureaux by NGOs to help them fight for their rights.

Must Indonesia Do Away with the Historical Trends? •

Be that as it may, it must be admitted that to meet the energy need in Java, sooner or later (and it is not likely to be much "later") Indonesia will have to make the tough decision of choosing the lesser of the two evils, namely coal or nuclear. She must make the choice by considering factors which would render one of the two undersirable candidates relatively more preferable to the other. These factors include: (1) safety; (2) environmental impacts; (3) cost; (4) financial and technological dependency.

The picture for Indonesia looks very bleak, as the following analysis for developing countries, done by Goldemberg, *et al.*, shows.

In the first half of this decade, commercial fuel use in the developing countries rose by 22 per cent, which was distributed among various sources, namely nuclear (348 per cent, from a small base), hydroelectricity (37.5 per cent), natural gas (39 per cent), coal (27 per cent), and oil (6 per cent).

Such a growth in energy consumption comes at a high price: air and water pollution, land disturbance, nuclear proliferation, social displacement, and global climatic change. For the majority of the countries, which must import oil and coal, and even for those countries which have oil and/or coal but must import technology, like Indonesia, it also means a continuing heavy burden of foreign debt.

In addition to the heavy demand for foreign exchange, traditional energy supply investments are highly capital intensive and provide relatively few jobs. This is exactly the reserve of what the developing countries need. By 2,025 the working-age population in the developing countries will be greater than the world's current total population.

However, to raise the standard of living the developing countries do need energy. For instance, how much energy Indonesia will need to reach the standard of living of western European countries in the mid-1970s. There is a strong historical correlation between energy use and GDP. The global disparities in the rate of energy use might seem to be further evidence; in 1980, primary energy use per capita averaged 6.3 kW in the industrialised countries, but only 1.0 kW in the developing countries. Moreover, only 0.55 kW of this 1.0 kW came from using commercial energy, the rest was non-commercial energy, such as firewood, dung, and crop residues.

Planning in the developing countries, including Indonesia, has emphasised expansion of energy supplies, resulting in the growth of per-capita energy use at a rate of 3.6 per cent per year in the 1970s. This growth has been costly, especially for oil-importing developing countries, whose oil import grew at an average annual rate of 6.3 per cent during 1970s. By 1981, low- and medium-income developing countries, spent respectively, 61 and 37 per cent of their export earnings on oil imports. Besides, the developing countries also purchased the technology not available at home for industrialisation and agricultural modernisation purposes and pay interest and the instalments as well of their foreign debts. A debt repayment crisis emerged. For Indonesia, the strengthening of the Yen made the debt plight even more burdensome. The economic growth of many poor countries stalled, and that of Indonesia plummeted from a high 7-8 per cent to only 2-3 per cent.

The high cost of expanding energy supplies has not been confined to oil import. Domestic investment committed to expanding energy supplies in developing countries increased from about 1 per cent of GDP in 1970 to 2 or 3 per cent in 1980, and the foreign exchange requirements for energy investment in developing countries totalled some US\$25 billion in 1982, which was one third of the amount of foreign exchange for all kinds of investments.

If the pattern of the 1970s were to persist, the average per-capita rate of primary commercial energy use in developing countries would increase from 0.55 kW in 1980 to 2.3 kW in 2020. This implies that aggregate commercial energy use in these countries would increase from less than 2 TWe per year in 1980 to nearly 15 TWe per year in 2020, in the light of the near doubling of the population expected by then. The increment in total energy use predicted using "historical trends" is equivalent to 1.3 times total world energy use in 1980, 3 times world oil production, 5 times world coal production, nearly 9 times bio-energy production, or nearly 60 times nuclear production in 1980. The Third World's economy would simply collapse!

Energy for Basic Human Needs

Allocating enough energy to satisfy basic needs is of central importance in energy planning. It is important, therefore, to estimate the energy requirements of a future course of economic growth aimed at satisfying basic human needs. In the Latin American world model of the Bariloche Foundation, the path of the future economic growth is determined by distributing capital and labour among the various economic sectors to maximise life expect-

tancy at birth. The model also has targets for nutrition, shelter, and education: a daily intake of 3,000 kcal and 100 grams of protein per person, 7m² of housing per person, and 12 years of basic education for all persons aged 6 to 17.

The estimate energy requirements for satisfying basic human needs is given by the following equation:

$$E_{bhn}/P = E_b/P + (CEI \times \Delta GNP/P)$$

where E_{bhn}/P = the per-capita energy required to satisfy basic human needs (say, in watts per capita)

E_b/P = total (i.e., commercial and non-commercial) rate of per capita energy use in the base year

CEI = present average commercial energy intensity of the economy (in dollars per capita) required to satisfy basic human needs;
 $\Delta GNP/P$ = increment in per-capita GNP.

The table below shows the application of the above formula for Latin America, Africa, and Asia. We can see that basic human needs would be reached in Asian developing countries by 2020, with a per-capita energy use of 1.8 kW. Even this lower rate is still quite difficult for Indonesia to achieve.

The 1975 BATAN-PLN Energy Seminar concluded that the share of electricity in the commercial energy use was to be raised from 15 per cent to 40-59 per cent by the year 2000. Since then the government has been raising the supply of electrical power by building hydro-electrical, geothermal and coal-fueled power stations, but it is not certain whether it can keep up with the growth of the population. It is assumed, therefore, that the share remains at the level of 15 per cent or there-about. It is also safe to assume that non-commercial energy use in Indonesia is about 60 per cent of the total energy consumption. Thus with the current total electrical power of 4,000 MWe and population of about 170 million, the per capita rate of energy consumption in Indonesia is 0.392 kWe. The subsistence energy need is normally assumed to be 400 kgce per capita, per annum. With a conversion factor of 8 kWe/kgce, this is equivalent to 0.367 kWe.

We see that the rate of per capita energy use in Indonesia is only about 1.07 times the subsistence level, or 39.2 per cent of the 1980 average of the per capita energy use in developing countries. It looks even dismally lower if we

compare it with the estimate of 1.8 kWe which should be achieved by developing countries in Asia by the year 2020, if use be made of the Latin American model of Basic Human Need. If this were not convincingly small yet, then one should compare it with the projected rate of energy use of 2.3 kWe/capita, which would have to be reached by the year 2020 if the trends in the 1970s were to persist.

Table 1

ESTIMATED ENERGY REQUIREMENTS FOR SATISFYING BASIC HUMAN NEEDS,
ASSUMING HISTORICAL ENERGY/GROSS NATIONAL PRODUCT CORRELATIONS

Region	1970 per capita		Commercial Energy Intensity in 1970 (Watts per 1980 dollar)	Required Increment in Per Capita		Date by Which BHN Could be Satisfied ^d	Per Capita Energy Use Required to Satisfy BHN (kW)
	GNP (1980 dollars)	Energy Use ^a (kW)		GNP ^b (1980 dollars)	Energy Use ^c (kW)		
Latin American	1,440	1.1	0.64	958	0.6	1992	1.7
Africa	400	0.7	0.70	1,051	0.7	2008	1.4
Asia	291	0.7	1.11	1,023	1.1	2020	1.8

- a. Includes an estimated 0.4 kW per capita of non-commercial energy use.
b. This is the increment in per capita GNP, above the 1970 level, required for the satisfaction of basic human needs, as estimated with the Latin American world model (see A.O. Herrera, et al., *Catastrophe or New Society: A Latin American World Model*, a report of the Fundacion Bariloche (Ottawa: International Development Research Centre, 1976).
c. Based on the commercial energy intensity in 1970.
d. As estimated with the Latin American world model, assuming that implementation of the BHN policy begins in 1980.
e. For the case in which the maximum annual yield of edible products is assumed to be increased from 4 to 6 tonnes per hectare in order to avoid collapse of the society.

Source: Goldemberg J., et al., *Energy for Development* (Washington, D.C.: World Research Institute, 1987), Table 12.

In another projection made by the State Electricity Company (PLN), the supply of electrical power is to be raised to meet a per capita annual consumption

of 1,440 kWh by the year 2000. Assuming that this will be realised along with the increased share of electricity to 40 per cent of the total energy consumption, and assuming further that the non-commercial energy use is still at the high level of 60 per cent of the total energy use, we will have a rate of per capita energy use of 1.03 kWe by the year 2000. While this is better than the 0.392 kWe that we have arrived at, above, it nevertheless is still a far cry from the projections based on the historical correlation between energy consumption and GDP.

Clearly, a way must be found to decouple development and economic growth from the rate of energy use. By adopting conservation measures and employing energy-efficient high technology, the western European industrialised countries have provided evidence that this decoupling can be done. But, then, there are factors there which favours the decoupling. The factors, which are lacking in the developing countries, are: (1) the high level of education of the citizens; (2) the energy-efficient, highly-sophisticated technology and the appropriately-matching culture of the society; and (3) the already very high level of per capita energy consumption. It remains to be seen whether the decoupling can be brought into effect in this country but Indonesia must try to do it. Perhaps Indonesia should quit being on the economically and environmentally-unsupportable supply side, and try to take the soft path towards an end-use energy strategy.

Liek WILARDJO

The Gorbachev Initiatives and the Security of the Asia-Pacific Region

Since his election as General Secretary of the CPSU in March 1985 and now also as President of the USSR, Mr. Mikhail Gorbachev has taken a series of bold peace initiatives that are likely to have a significant impact not only on Soviet relations with the outside world but also on relations among nations the world over. Indeed, these initiatives have contributed to the creation of a new, more favourable international climate that is currently marked by a trend

towards the easing of tension, a shift from confrontation to reconciliation, and towards dialogues and co-operation among nations large and small, whatever their social, political, and economic systems.

Two major documents embodying Mr. Gorbachev's initiatives that directly concern the Asia-Pacific region are his Vladivostok speech of July 28 1986 and his Krasnoyarsk speech of September 19 1988. Given the chance of their full implementation, such initiatives would be conducive to the creation and maintenance of peace and security of the world, a constant dream of mankind that would enable all the nations of the world, through mutually beneficial co-operation, to make full use of their resources for their national developments towards the fulfilment of human needs that transcend all other interests. But how are Mr. Gorbachev's initiatives to be realised, and what is the possibility of their realisation particularly as far as the Asia-Pacific region is concerned? This, to my mind, would be determined not only by the Soviet Union itself, particularly on the part of its leadership, no matter how determined they may be to implement what they have set out to do; it would also depend on the response, understanding and co-operation of other nations. It cannot be an exercise of clapping with one hand.

In order for the other nations, particularly in the Asia-Pacific region, to give their positive response and to offer their co-operation in the efforts to help realise Mr. Gorbachev's initiatives they need to fully understand the Soviet intentions with a view to overcoming possible prejudices, suspicions, misperceptions, and perhaps even fear whatever their reasons, and then hopefully to developing mutual trust. But this, again, will not be a one-way affair. The Soviet Union must provide the reassurance. Simple repetition or reaffirmation of the proposals will not suffice. It should also further clarify certain things, elaborate on certain points, and above all follow up words with deeds, which in some cases it has indeed been done as in the case of Afghanistan and in the signing of the INF Treaty with the United States. There is little doubt that the withdrawal of the Soviet troops from Afghanistan, if still pending its completion, and the signing of the INF Treaty between the Soviet Union and the USA, the most far-reaching disarmament agreement thus far, have been due to a large extent to the goodwill and sincerity of the present Soviet leadership under Mr. Gorbachev. These instances have certainly helped to assure the world of Soviet peaceful intentions.

As far as the security of the Asia-Pacific region is concerned, what seems to be the most important proposal that has been put forward by Mr. Gorbachev in his Vladivostok speech is one for a conference, in his own words, "in the

mold of the Helsinki conference, to be attended by all countries gravitating towards the Ocean." Indeed, it should be noted here that although the idea of the Helsinki conference -- with the Helsinki accords as its final outcome -- is basically understood, it seems that Mr. Gorbachev's emphasis that on this issue the Soviet Union stands "for integrating the Asia-Pacific region into the general process of establishing a comprehensive system of international security as proposed at the 27th Congress of the CPSU" would need further clarification as to what he actually means. Of all people, Mr. Gorbachev must certainly be aware of the great differences between Europe and the Asia-Pacific region in terms of history, geographic and geopolitical setup, cultural traditions, social, political, and economic levels of development, etc. And in terms of security, unlike Europe, the nations of the Asia-Pacific region vary widely in their perceptions of both internal and external threats to their security, individually as well as collectively. The wisdom of applying the European experience to the Asia-Pacific region seems therefore to be highly questionable.

Irrespective of the proposal for a Helsinki-type of conference, however, and without prejudice to such a proposal, what Mr. Gorbachev has called the Soviet "concrete views" on the issue, which consist in fact of five concrete steps proposed to be taken seem more sensible, desirable, and probably feasible, whether or not they are to lead to the holding of a Helsinki-type of conference. In fact, Mr. Gorbachev's seven proposals that he put forward in his Krasnoyarsk speech may be regarded as a further expansion and elaboration of those that he had mentioned in his Vladivostok speech.

It is clear, however, that the implementation or realisation of such fine ideas would have to be determined and agreed upon first and foremost by the great powers in the region, particularly the Soviet Union itself, the USA, the People's Republic of China, and probably Japan, and then the other nations. Those proposals of Mr. Gorbachev related to nuclear weapons, for example, such as the establishment of nuclear weapons free zones and the freezing of the amounts of nuclear weapons, must above all be agreed upon jointly by the nuclear powers. But reduction of the level and activity of naval and air forces would have to be agreed upon by other nations, not only the nuclear powers, that maintain naval and air capabilities in the region. And the creation of a negotiating mechanism, especially for discussions on confidence-building measures, may involve all the nations in the region, big and small, nuclear and non-nuclear alike.

Again, the holding of a Helsinki-type of conference notwithstanding, the Soviet intention as emphasised by Mr. Gorbachev particularly in his Vladivos-

tok speech to promote and improve bilateral relations, especially in the non-military fields, with all the nations of the Asia-Pacific region is worth noting. It may help improve the Soviet image in the region and thus reassure the region of Soviet peaceful intentions. The perceptions of many nations in the region regarding the Soviet Union may then be less characterised by a military, aggressive, and expansionist nature. This is important, for the improvement of bilateral relations between the Soviet Union and the other nations of the Asia-Pacific region would depend certainly not only on the Soviet desire, but also on the positive response of the other nations of the regions, which in turn would be determined partly by their perceptions of the Soviet Union.

Most important and most welcomed have been the evolving detente between the Soviet Union and that between the Soviet Union and the PRC, which would significantly impact on the Asia-Pacific region, and indeed the whole world. The easing of tension seems to have had positive and constructive influence on efforts at solving regional conflicts all over the globe, if the process towards their final solution may still be a long way off. Of particular significance will be expectations of many in Southeast Asia that the Sino-Soviet reconciliation may help speed up the political settlement of the Kampuchean conflict, although the role of other nations, not only in the region of Southeast Asia but also those outside the region may not be ignored.

What seems to be missing is the prospect of improved relations between the Soviet Union and Japan. Indeed, in his Vladivostok speech Mr. Gorbachev did not fail to mention at length his appeal to improve relations with Japan. But while he made mention of regional conflicts, particularly those in Afghanistan and Kampuchea, Mr. Gorbachev made no reference whatsoever to Japan's claim to the Northern territories, which have been under Soviet occupation since very shortly after the end of World War II. The Soviet Union may not admit the existence of a "dispute" with Japan over these territories. But to Japan, and this the Soviet Union cannot simply brush aside and ignore as though the problem did not exist, the issue of the Northern territories is the main or even the only major obstacle to improvement of relations with the Soviet Union. Without prejudice to Japanese or Soviet interests, a solution must be sought of this problem by the two countries, which would have great significance to the security situation in the Asia-Pacific region. Especially for Japan, but certainly for many other nations in the region as well, what the Soviet Union would ultimately do on this issue may be another test for Soviet good will and intentions.

Thus the Soviet Union still has a lot of homework to do to improve its bilateral relations with the nations of the Asia-Pacific region which would help ensure the creation and maintenance of peace and security in the region. This is not to say that the Soviet Union alone will have to bear the responsibility. It is certain that the other nations in the region are just as anxious and interested as the Soviet Union in the creation and maintenance of lasting peace and security of the Asia-Pacific region. They are likely also to be interested in the success of Mr. Gorbachev's domestic reforms in the context of *glasnost* and *perestroika*. And they are likely to be interested in co-operation with him in that regard, particularly as they relate to his foreign relations. That's why it seems certain that they welcome also Mr. Gorbachev's peace initiatives, especially to the extent that these initiatives concern the Asia-Pacific region. And they are likely to be interested in taking joint actions with the Soviet Union on those initiatives. But the process may still be long before their fruition. And not only from the other nations of the Asia-Pacific region, but more particularly from the part of the Soviet Union, now that Mr. Gorbachev has started the ball rolling by taking those bold initiatives, a lot more is to be forthcoming.

J. Soedjati DJIWANDONO

Indonesia's Economic Development: Recovery after Deregulation

Djisman S. SIMANDJUNTAK

Indonesia's economic management is based among other things on a five-year development plan in which the major targets of economic development and its financing are set in a very indicative way. The Fourth Five Year Development Plan (Pelita IV) will be completed by March 31 1989 while Pelita V will immediately start thereafter. For various reasons the coming Pelita V is said to have a special meaning to Indonesia's long-term development. In the course of Pelita V the country is supposed to finalise the preparations for a "development take-off" which has lately become an important entry in Indonesia's political rhetorics, if it remains nebulous so far.

Viewed from the perspectives of economic development, the transition from Pelita IV to Pelita V is of great relevance to be discussed. Plagued by the plunge in oil prices and the appreciation of the Yen, Indonesia's economic performance deteriorated rapidly in the period covered by Pelita IV. At the same time, however, this deterioration created a golden opportunity for the government to remove at least some of the restrictive policies introduced during the heyday of oil. The policy overhaul is aimed at the earliest possible return to high growth with an increasing reliance on the non-oil sector as a source of both foreign exchange and saving. The reforms have started to show result at least on some accounts. The economy has recovered since 1987 and its performance in 1988 is expected to improve further. Therefore, the starting conditions of Pelita V are likely to be more favourable than those of Pelita IV. However questions arise as to how long this recovery will last and the extent to which it will be robust enough to be able to bring about an improvement in employment, poverty alleviation and other problems that continue to afflict Indonesia in spite of its relatively good economic performance in the 1970s.

The first section of this paper will picture the achievements of the Indonesian economy during Pelita IV as these achievements are bound to affect what Indonesia can attain in the coming five years. The likely performance will be discussed in section two in a more speculative manner, before we turn to the identification of major issues that need to be dealt with in the course of Pelita V.

PELITA IV: POOR PERFORMANCE, BOLD REFORMS

Indonesia's economic performance had started to deteriorate even before Pelita IV as was launched in April 1984 which can be seen from Table 1. Growth performance in Pelita III had weakened considerably compared to Pelita II which in turn was weaker than Pelita I in terms of economic growth. However, growth performance differs strongly from one sector to another. Deterioration was particularly strong in mining and quarrying and construction while agriculture performed surprisingly well. In fact, it is because of the

Table 1

GROWTH RATES OF INDONESIA'S GROSS DOMESTIC PRODUCTS¹

	Average Pelita II	Average Pelita III	1984	1985	1986	1987	1988 ²
Total	7.2	6.1	6.0	2.3	4.0	3.6	4.7
Agriculture and Forestry	3.0	4.2	4.2	4.2	2.6	2.6	-
Mining and Quarrying	4.8	-1.8	5.9	-5.5	4.6	-3.7	-
Manufacturing	13.7	9.5	19.0	8.3	4.7	7.8	-
Construction	15.1	8.8	-4.4	2.6	2.2	6.0	-
Trade, Hotel, Restaurants	-	-	1.3	1.7	4.3	6.0	-
Transport and Communication	14.9	7.9	11.7	0.9	3.3	4.7	-
Bank & Other							
Financial Services	-	-	18.8	0.3	5.5	4.4	-
Public Administration &							
Defence	-	-	5.0	7.4	6.3	7.3	-

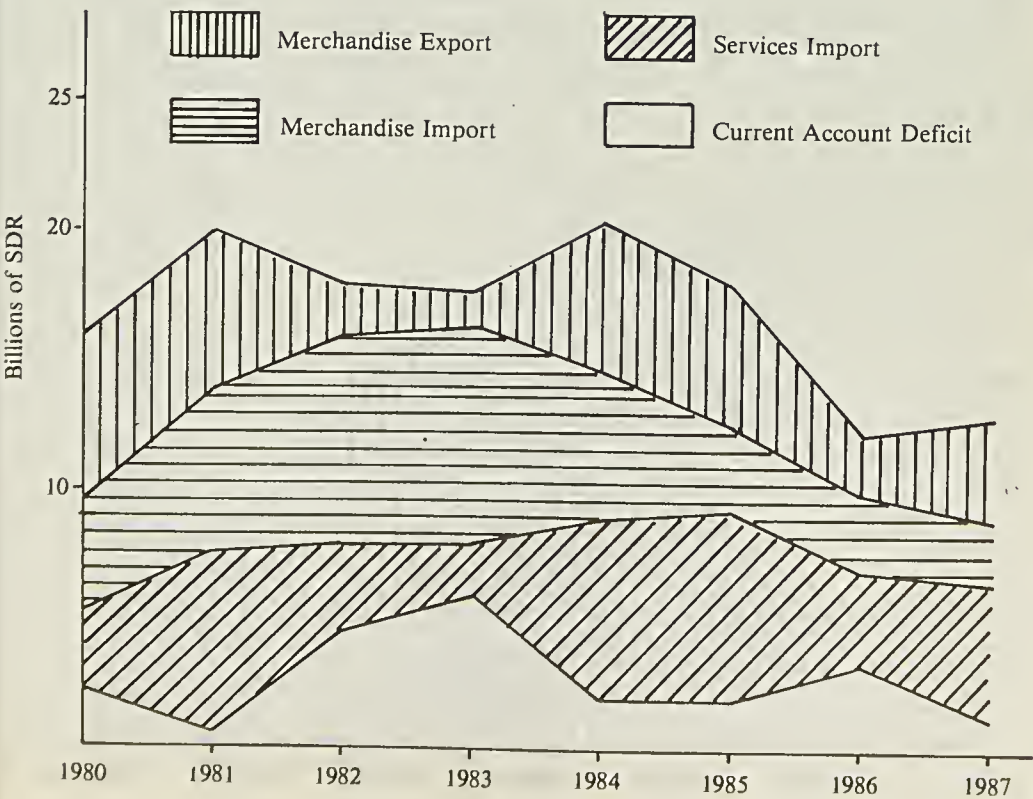
Notes: ¹Pelita II & III constant 1973 prices; thereafter constant 1983 prices

²Estimate

Source: Central Bureau of Statistics, *National Income of Indonesia*, various volumes.

relatively strong performance of agriculture that Indonesia managed to maintain a positive growth rate even in the most difficult year of Pelita IV. A more serious deterioration occurred in the country's balance of payments. As can be seen from Figure 1, export of merchandise declined rapidly. The level of export remained below that of 1981 even in the last year of Pelita IV. A similar trend is observable in export of services. Given the limited financing possibilities, Indonesia responded to this decline with different types of contrastive policies. As a result of it the import of merchandise declined and started to recover only in the last year of Pelita IV. Import of services, however, with investment income in the forms of interest payment and profit of foreign direct investment as the main component, continued to rise until 1985. Although it declined considerably in 1986 and 1987, its absolute size continued to exceed trade surplus and export of services combined, meaning a deficit in the current account which in turn fluctuated erratically and forced two major

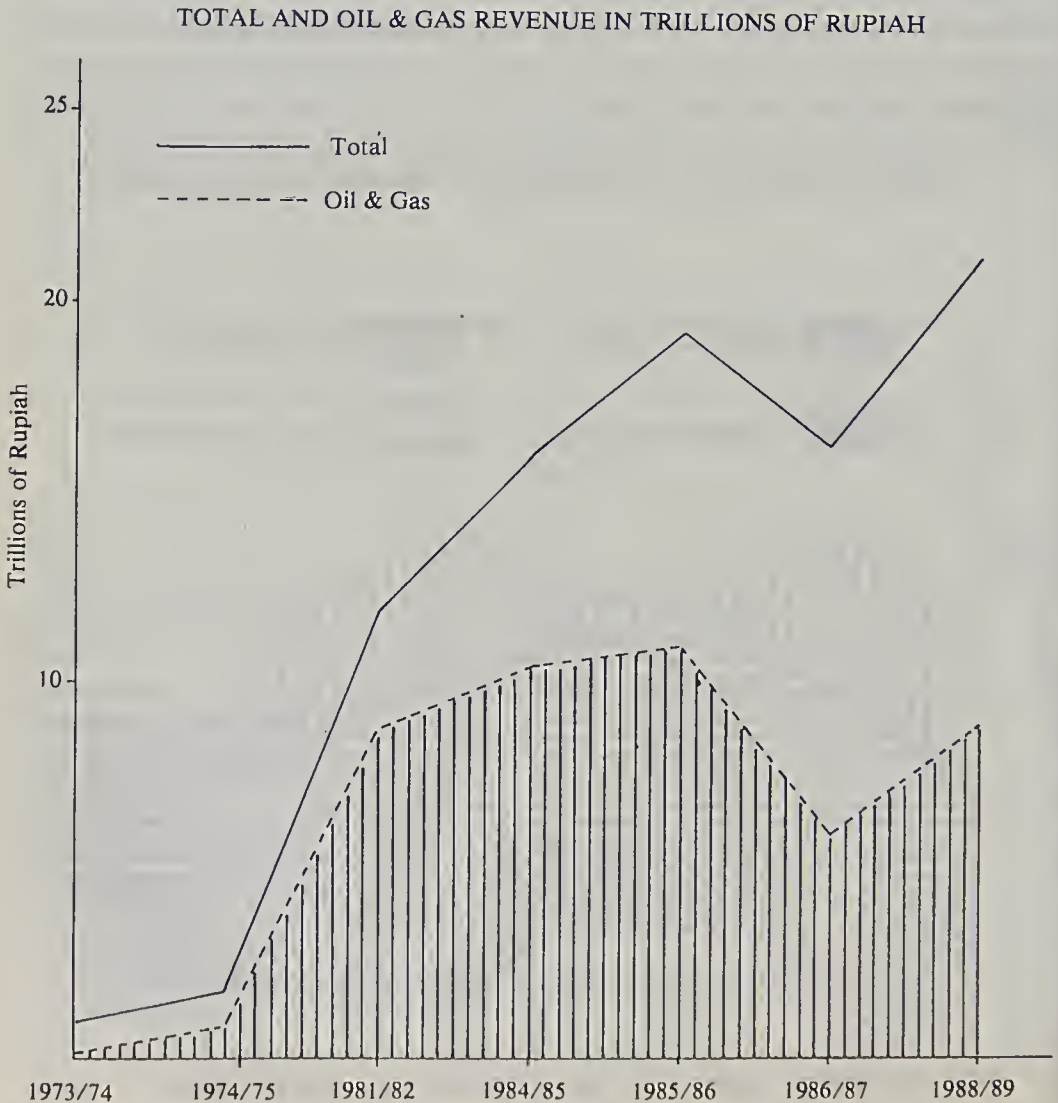
Figure 1
SELECTED INDICATORS OF INDONESIA'S CURRENT ACCOUNT 1980-1987



devaluation in March 1983 or immediately before the launching of Pelita IV and in October 1986 respectively. As the amount of capital import through private borrowing and foreign direct investment was by far too little to finance the rising deficit in the current account, the government decided to function as a "borrower of the last resort." This is one of the reasons behind the rapid growth of the government's external debt during Pelita IV.

Royalty from oil and natural gas, called "Oil Corporate Tax" in Indonesia's budget vocabulary, has always been the backbone of government finance in Indonesia as can be seen from Figure 2. Its contribution to the government's total domestic revenue increased dramatically from only 39.5 per cent in 1973

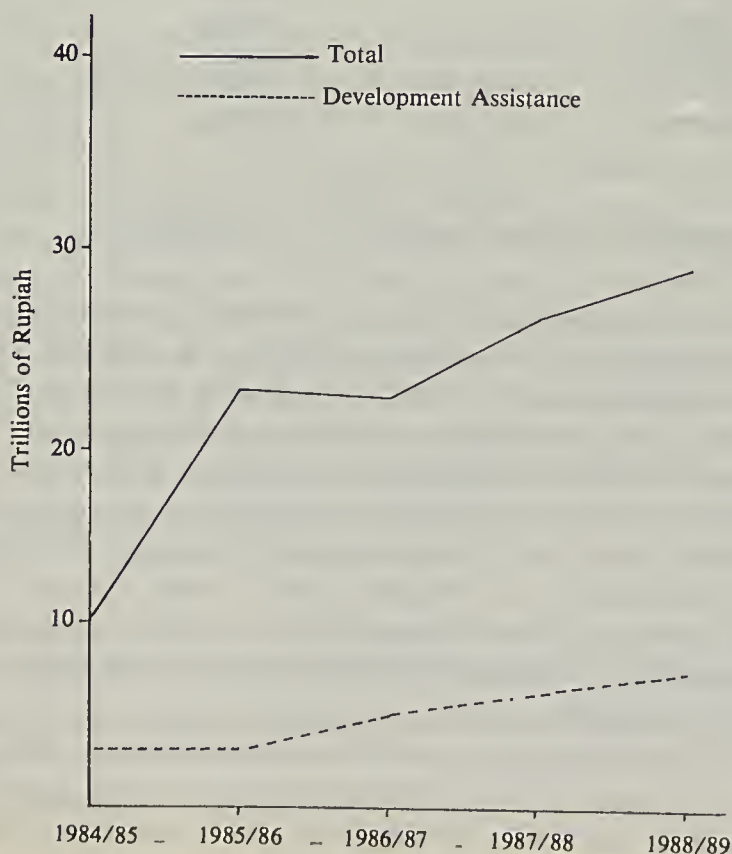
Figure 2



to 54.6 per cent in 1974 and to as high as 70.6 per cent in 1981. Even with the already marked decline in oil prices, the contribution of oil and gas revenue contribution to the budget remained as high as 65.6 per cent in 1984 and 40.6 per cent in 1988. Any fluctuation in oil price is, therefore, bound to have serious impacts upon government finance. As oil price declined steeply during Pelita IV government savings, defined as the difference between domestic revenue and current expenditure, fell to a very low level, far too low as compared to the perceived need for development expenditure. As a result, the government decided to borrow heavily from outside as the financing of deficit through domestic borrowing is abandoned for various reasons. Disbursement of external debt increased as a fraction of both total expenditure of the government and gross domestic product as can be seen from Figure 3.

Theoretically speaking, public sector enterprise and the private sector can compensate for the decline in government spending to maintain a certain level of domestic demand. The central government alone maintains about 220 state

Figure 3 TOTAL EXPENDITURE AND DEVELOPMENT ASSISTANCE



enterprises of which some are among the biggest enterprises in Indonesia. They control strategic business lines through monopoly or near-monopoly with an estimated asset of about 80 billion US dollars by the end of 1987. The saving performance of these enterprises is, however, chronically weak.¹ They also rely on the government budget for the financing of their investment, at least until recently. In other words, the investment performance of the state enterprises is also sensitively dependent on oil prices. This poor investment performance of the public sector and a moderate increase in the investment of the private sector's investment amount to a decline in total investment in real terms as can be seen from Table 2.

Table 2

GDP AND GROSS FIXED INVESTMENT IN BILLIONS
OF RUPIAH, 1983 PRICES

	GDP	Gross Fixed Investment
1982	71,377.2	18,740.3
1983	73,697.6	18,973.8
1984	78,144.4	17,847.5
1985	80,014.4	16,768.1
1986	82,474.5	16,933.0

Source: The World Bank, *Indonesia. Country Economic Report 1988*, p. 159.

The extent to which unemployment has worsened as a result of the weakening growth and investment performances is difficult to establish. The definition of unemployment currently used by the Central Bureau of Statistics is very loose. As a result, the figure on open unemployment does not tell anything significant about the unemployment conditions. It remains very small even when the rate of growth of GDP was low in the last eight years. The standard explanation for this anomaly is that people who cannot find jobs in the formal sector have gone to the "informal sector" doing whatever is at hand for survival.² However, unemployment is widely perceived to be among the most serious problems afflicting Indonesia today and during Pelita V.

¹See for instance Djisman S. Simandjuntak, "Performance of Public Sector Enterprises: The Indonesian Case," in *Indonesian Quarterly*, Vol. XVI, No. 2 (April 1986), pp. 227-242.

²On the current employment issues in Indonesia, see Aries Ananta, "Employment in Indonesia in Pelita V," *Indonesian Quarterly*, Vol. XVI, No. 4 (this issue, October 1988), pp. 426-439.

Table 3

THE PERCENTAGE SHARES OF PEOPLE WORKING LESS THAN 35 HOURS A WEEK
IN THE TOTAL NUMBER OF PEOPLE WORKING IN EACH SECTOR, 1986

	Hours Worked a Week				
	0	1-9	10-24	25-34	1-34
Agriculture	1.8	5.0	28.1	21.4	54.5
Industry	0.7	2.7	15.1	11.1	28.9
Trading	1.2	2.4	14.9	12.3	29.6
Services	1.4	1.6	8.8	13.6	24.0
Others	1.9	3.7	16.5	13.8	34.0
All Sectors	1.7	4.2	23.1	17.5	44.8

Source: Central Bureau of Statistics, *Keadaan Angkatan Kerja (Conditions of the Labour Force)*, 1986.

In spite of a relatively successful family planning programme as reflected in the declining population growth rate, Indonesia's labour force continues to grow at a high rate. During Pelita IV, the number of population in the age group of ten years and over searching for jobs is estimated to have increased by 9.3 million and another 9-10 million is expected to enter the labour market for the first time during Pelita V. This new entrance into the labour market alone points out already the big challenge, the need to create employment. Yet, in addition, there is also a serious problem of underemployment, the nature of which is only poorly understood. In 1986, no less than 44.8 per cent of Indonesia's labour force worked only 34 hours or less a week as can be seen from Table 3. The level of underemployment was particularly high in agriculture which in turn absorbed about 55 per cent of the total labour force. More than half of the labour force in the agricultural sector was underemployment in the sense of working less than 35 hours a week.

The problems of unemployment facing Indonesia at present are aggravated by the very high degree of geographical concentration which has been seen as a serious problem since many years ago. The transmigration programme has turned out to be inadequate to lessen the population pressure in Java, Bali and Sunda Islands and to increase the supply of labour in the thinly populated areas of Kalimantan, Sulawesi, Irian Jaya and Sumatra, implying that the old

problem of factor disproportion persists. There is an oversupply of labour in Java relative to the supply of other resources while in other major islands shortage of labour prevails in terms of the natural resources available. The average level of education of the labour force remains low in spite of the rapid expansion of educational services in the last 15 years or so. Over half of Indonesia's labour force in 1986 had not completed elementary school. An imbalance also exists between general education and vocational training. Preference for general education continues to be very strong in spite of the fact that over one third of the graduates of these schools for general education failed to find a job in 1986. At the level of university education there is a similar imbalance. The number of students in the liberal arts and teaching institutes continue to outnumber those enrolled in sciences in spite of the well-known fact that a big number of graduates in social sciences have proved unable to find jobs that suit their formal training. In short, unemployment has turned out to be one of the major problems Indonesia has to carry over into Pelita V. The informal sector cannot provide the ultimate solution to this problem. It is widely recognised that a high growth rate in the formal sector is what Indonesia needs to cope with unemployment problems. The next question, therefore, is how to make this rapid growth possible, given the resource constraints facing the economy.

A MARATHON OF DEREGULATIONS

From the outset of Pelita IV the government has recognised the need to change the orientation of the economic development in various ways: from a government-led economy to one where the private sector plays a greater role; from import-substitution to export-led development; from oil sector to the non-oil sector. In other words, the need for policy reforms covering all branches of economic policy had already been felt even before Pelita IV was launched in 1984. However, the government stated again and again that it was not going to change its position on such fundamental issues as that of domestic borrowing and rescheduling of external debts even when the net resource transfer from external borrowing or the difference between disbursement and total debt services has become negative since 1985 and the difference has tended to widen in the subsequent years. As a result, the economic reforms had to proceed in an extremely austere environment with export being the only possible source of expansion of total demand.

The main elements that Pelita IV has accomplished in terms of economic reform will be discussed in this section with the primary purpose of featuring

the starting environment for Pelita V. In doing so, one has to take into account the two major changes introduced in the last year of Pelita III. Only a few months just before Pelita IV was launched, the Rupiah was devalued by 27 per cent against the US dollar, providing thus an incentive to export-oriented activities in the subsequent years. In June 1983, a major deregulation package in the banking sector was announced. Credit ceiling was lifted. Commercial banks were given the freedom to expand their lending to the extent allowed by their respective liquidity position. Fixed interest rates were removed. At least theoretically, banks are now free to set both deposit and lending rates, except for a small number of priority areas in which the government maintains preferential credit schemes with a subsidised interest. On the other hand, the liquidity credits provided in the past by the Central Bank to the commercial banks were withdrawn except for the priority areas mentioned earlier. Commercial banks are now required to rely on funds mobilised through equity and savings and to turn to the Central Bank only as lender of the last resort.

Following the June deregulation package, interest rate moved upwards and stayed at a high level during Pelita IV. The amount of saving mobilised by banks increased rapidly as well, but a new problem arose as the high level of interest rate was said to have worked as a disincentive to investment.

In the meantime, the prices of primary commodities, especially that of oil, deteriorated further. The need for an early expansion of non-oil export became more urgent and so was the need for an increase in foreign direct investment. After recognition of the fact that the steep decline in the prices of primary commodities has eroded Indonesia's attractiveness to foreign investors, new initiatives were considered necessary to restore the confidence of investors in the economy. A major step of deregulation was announced in 1985. The surveillance of transborder flows of goods was transferred from the customs administration to a Swiss-based surveyor to speed up the flow of both export and import as well as to minimise rent-seeking related costs which traders had been complaining about for many years. A number of ports were open to foreign shipping companies, and tramp shipping were allowed to enter Indonesian waters. At the same time, the management of ports was delinked from the Department of Transportation in the hope that port efficiency would improve. This was an important step in view of the widely shared hypothesis which attributed an important part of the high transportation costs to port fees rather than to other elements of the transportation system.³

³See for instance Alexander Yeats, "The Incidence of Transportation Costs on Indonesian Exports to The United States," in *Bulletin of Indonesian Economic Studies*, Vol. 12, 1976, p. 69.

Aware of Indonesia's relatively poor performance as compared to other countries in mobilising tax revenue and in anticipation of a further decline in oil revenue, the government introduced a series of tax initiatives between 1983 and 1986. The old Individual Income Tax and Corporate Income Tax were replaced by a unified Income Tax. While higher rates were imposed on corporate income in the old income taxes, an equal treatment is provided by the new law to the two types of income. The number of rates was reduced to only three in the new Law on Income Tax, namely 15 per cent, 25 per cent, and 35 per cent, meaning at the same time that the highest rate of income tax was reduced from 45 per cent in the old corporate income tax. However, some inconsistencies remained in force as clearly reflected in the compromise regarding the exemption given to interest income which was maintained until 1988, for fear of capital flight.

A Law on Value Added Tax was passed in 1983. Its enforcement was postponed until 1988 due to administrative difficulties. The VAT contains some improvements compared to the old sales tax. It avoids, for example, taxation on taxes found in the sales tax system, if only partially. It has a much simpler structure of rates. While the old sales tax had a big number of rates that varied according to whether or not the goods in question were comprised in the category of "essential goods," the VAT has only two rates, namely 10 per cent and 20 per cent. However, the VAT now in force is still very incomplete in terms of coverage. It does not cover the primary sector such as farming, cattle breeding, fishing, food drying, packaging, restaurant and catering. Sales tax continues to apply to a wide range of luxuries. Finally, small scale business is excluded from the coverage of the VAT.

A new property tax called Land and Building Tax was also adopted in 1985. The rate is the same as that of the old Property Tax, namely 0.5 per cent, but the base is different. Historical value with periodic reassessment were used in the old Property Tax while the Land and Building Tax is based on market value which varies from one place to another.

There is another important aspect worth mentioning here with respect to the tax initiatives of the mid-1980s. Prior to 1984, tax liability could only emerge as a result of an announcement made by the tax administration on the basis of an assessment made by the tax administration. In the new tax laws, however, the principles of self-assessment was adopted. This implies a certain degree of deregulation which may also help to reduce collection costs as well as to narrow the room for "horse trading" between tax officials and taxpayers. Besides, the adoption of the new tax laws provided a good opportunity for the

government to multiply its taxation effort.

The preliminary result of the tax reforms is encouraging. The number of taxpayers has increased rapidly, though it remains very small in terms of the number of working population. The same applies to the tax base. As a combined result, revenues from Income Tax, VAT, and Land and Building Tax exhibit a strong increase as can be seen from Table 4. Tax revenue as a fraction of GDP has also increased from 6 per cent before the tax reforms to about 9 per cent at the end of Pelita IV. In other words, Pelita IV has laid the foundation for a more balanced structure of government revenue. In fact, the increase in tax revenue on the one hand and the decline in Oil Corporate Tax revenue on the other has resulted in a revenue structure that relies more heavily on non-oil revenue since 1986. On the expenditure side, the government finance has also undergone significant changes in the course of Pelita IV. Because of the decline in oil revenue and the rapid increase in external debt services and in view of the need to switch to a development strategy that is conducive to a greater participation of the private sector and a sustained growth of non-oil export, the government expenditure has been rationalised in the course of Pelita IV. In fact, one of Indonesia's earliest responses to the abrupt decline in com-

Table 4

TAX REVENUES BEFORE AND AFTER THE TAX REFORMS
(in Trillions of Rupiah)

	Income Tax	Value Added Tax	Land and Building Tax
1983/84	1,932.3 ¹	830.6 ²	144.9 ³
1984/85	2,121.0	878.0 ²	180.6 ³
1985/86	2,313.0	2,326.7	224.5
1986/87	2,270.5	2,900.1	190.0
1987/88	2,263.4	3,390.4	275.1
1988/89 ⁴	3,762.1	4,787.6	322.0

Notes: ¹Old Income Tax;

²Old Sales Tax;

³Old Property Tax;

⁴Budget Figure.

Source: *Financial Report of the Government 1988/89.*

modity prices during the first half of the 1980s was in the area of government expenditure, namely the decision to postpone the construction of various big projects planned during the oil boom. Different types of subsidy were also reduced or even abolished. Most of the subsidies known in Indonesia's budget vocabulary are not provided in the form of money transfer, but emanates rather from the underpricing of certain goods and services. What is at issue, therefore, is price policy. Increases in the price of fuel has led to a deep cut in fuel subsidy, though it may increase again should crude price increase faster than the domestic selling price of fuel. Food subsidy has also disappeared since 1983, and agricultural input subsidy is in the process of being phased out. Furthermore, capital participation in the numerous state enterprises which means in some cases a compensation for losses made rather than investment in new capacity, has declined rapidly. Between 1975 and 1985 the government spent cumulatively the equivalent of US\$5.3 billion on capital participation. Beginning in 1986, however, capital participation in state enterprises declined sharply, and state enterprises are now encouraged to look for funds in the capital market.

No doubt, some inconsistencies remain. Nevertheless, the steps towards a more rational expenditure introduced in the course of Pelita IV will make it easier for the government to direct its expenditure during Pelita V in such a way as to fit into the stated policy of greater openness of the economy. Following the reforms in the banking sector and government finance and the debureaucratisation in the trade supporting services, a series of deregulation packages in the areas of trade, investment and industrial policies covering a wide range of sectors were announced. In terms of number, the packages are too numerous to be discussed here one by one. Only the main elements will be highlighted to feature the environment which is likely to prevail at the start of Pelita V.

It is important to recall at this juncture that the Indonesian economy suffered from a high degree of regulations made during the time when the resource position of the economy was highly favourable. All the classic measures of import substitution strategy were used until 1985. One can, therefore, understand the policy reform of the second half of the 1980s as an attempt to remove at least the most restrictive parts of the measures which caused, among other things, a lack of interest on the part of industrial firms to export. In extreme cases, export were in fact made impossible through the inclusion of an industry in the negative list of the Investment Priority List once the approved capacity reached the level of the estimated domestic demand.

The situation changed gradually since the announcement of the first major package of deregulation in May 1986. Taking into account the packages announced until October 1988, one might say that openness of the economy has been restored to a great extent, though some restrictions remain in force, causing people to expect other deregulatory measures.

First of all, restrictions on entry have been relaxed. The coverage of the "black list" has narrowed considerably. Indeed, there is no entry restriction on export-oriented investment, that is, investment with an export-production ratio of 65 per cent or more. Banking, insurance, and even distribution were reopened to joint ventures through the October 1988 package, and a similar step is expected to be made in other industries. Secondly, local equity requirement in joint venture has been relaxed in a selective way. While the idea of local shareholder(s) majority remains alive, a much lower local equity ratio is allowed for specific projects, namely as low as 5 per cent for export-oriented joint ventures. Thirdly, local content regulation is in the cases of export-oriented companies, which now enjoy the freedom to import the intermediate product they need for the production of exportables if the price of the locally made product is higher than that of imported one. Fourthly, preferential treatment that has been reserved for domestic companies is now also granted to joint ventures with a local equity of 75 per cent or more or a local equity of 51 per cent but at least 20 per cent of the shares is sold in the stock market. Fifthly, foreigners are allowed to buy up to 20 per cent of the shares of existing domestic companies. Finally, preferential export credits, which had been reserved for domestically owned companies, is now made available to foreign companies.

One can certainly criticise the various packages of investment deregulation for being too gradual in nature as none of the performance criteria has been completely removed. The Investment Priority List remains in force with a negative list attached. The same applies to local equity requirement and local content regulation, if much softer than they were before 1986. The investment policy continues to discriminate against foreign companies as regards access to some sectors such as domestic distribution. Assuming their consistent implementation, the reforms imply, nevertheless, a greater openness that may help, in turn, to reduce rent-seeking activities which undoubtedly run counter to the efforts in improving competitiveness of Indonesian products both in domestic and international market.

Investment regulations would have been meaningless without the support of a restrictive trade policy. The higher the speed of import substitution a country

pursues, the greater the demand for a highly restrictive trade policy will be. In this regards, Indonesia is by no means an exception. Tariff rates ranged from 6.3 per cent on mineral fuel to 49.9 per cent on miscellaneous manufactures in 1980. A wide range of products were affected by non-tariff barriers in the same year as can be seen from Table 5. In fact, as late as 1985 the government introduced the notorious *tata niaga* or import regime which intensified the stringency of the trade regime by the granting of exclusive rights to certain privileged importers or producers to import certain products. By doing so, the government created a comfortable rent to be pocketed by the respective importers and sacrificed at the same time its customs revenue. When Indonesia embarked upon the promotion of non-oil export, it became clear that the success of this programme will crucially depend on the export performance of the manufacturing which, in turn, relies heavily on imported machinery and intermediate products. A freer trade policy is, therefore, badly needed. Beginning in 1986, the government has accordingly engaged in a liberalisation programme, the outcome of which belongs certainly to the major achievements of Pelita IV.

The directions followed in this liberalisation is clear. First of all, a freer trade policy is perceived to be superior to a more protectionist one. Secondly, the protection that will continue to be needed, has to abide by certain principles. It should be transparent to everybody and, therefore, rely on tariff rather than non-tariff measures. The liberalisation programme has resulted in

Table 5

NUMBER OF PRODUCTS AFFECTED BY NON-TARIFF BARRIERS IN INDONESIA
1980

	Restrictive Licencing	Quota	Import Ban	State Trading
Food, Beverage, Tobacco	1	0	213	23
Inedible Materials	31	0	44	3
Fuel, Vegetable and Animal Fats	1	0	2	1
Chemicals	53	4	0	0
Basic Manufactures	241	36	3	0
Machinery, Transport Equipment and Telecommunication Equipment	117	5	0	0
Miscellaneous Manufactures	10	0	11	0

a substantial liberalisation in the last three years. Tariff rates have declined considerably and the range has also narrowed, though tariff increase occurred in some cases to compensate for the removal of non-tariff barriers. Table 6 provides some information on the result of the tariff reduction programme. Progress has also been remarkable in the reduction of non-tariff barriers. The share of items under licensing in 7-digit CCCN (*Customs Co-operation Committee Nomenclature*) has decreased from 31.4 per cent before May 1986 to 21.7 per cent at the end of 1987. The import value covered by licensing as a fraction of total import has also declined from 42.9 per cent before May 1986 to 25.2 per cent at the end of 1987. The reforms so far are concentrated on the manufacturing sector while agriculture has hardly changed in terms of non-tariff barriers it enjoys. Within the manufacturing in turn, textiles, clothing and footwear that is industry with the best export performance outside the resource-based industry, exhibited the most rapid reduction of non-tariff barriers, though liberalisation has also been remarkable in other industries as can be seen from Table 7. This liberalisation programme is expected to continue in the years to come especially in respect of the items which currently continue to enjoy high protection through restrictive import licensing.

Table 6

FREQUENCY INDEX OF INDONESIA'S NOMINAL TARIFF RATES, %*

Tariff Rates	Tariff Schedules		
	1980	1985	1987
Up to 15%	41.9	50.3	51.7
Up to 20%	47.8	64.0	64.0
Up to 30%	58.7	81.8	80.6
Up to 40%	70.6	91.5	90.0
Up to 50%	77.9	96.2	95.1
Up to 60%	90.1	99.6	99.5
Up to 80%	95.1	99.6	99.6
Up to 100%	99.6	99.9	99.9
Up to 200%	100	100	100

Note: *Number of CCCN items in each of the tariff classes as a percentage of total CCCN items in the respective schedules

Source: The World Bank, *Indonesia, Country Economic Report 1987*.

Table 7

PERCENT OF DOMESTIC PRODUCTION COVERED BY IMPORT LICENCES*

	Before May 1986	Post December 1987
Textile, Clothing and Footwear	64.0	38.2
Wood Products	0	0
Paper and Printing	69.6	50.4
Chemical Products	59.9	51.1
Non-Metallic Products	28.2	21.7
Basic Metals	45.5	29.2
Engineering Products	86.7	60.3
Other Manufactures	28.9	24.6
Total Manufacturing	49.1	34.8

Note: *1985 value of domestic production minus exports protected by restrictive import licences as a share of total domestic production

Source: The World Bank, *Indonesia, Country Economic Report 1988*, p. 61 and 64.

Another important element of the trade policy programme is Indonesia's increasingly active participation in different endeavours which explicitly seek to restore an open trading environment. This was not the case in the 1970s when the country's export was dominated by such primary commodities as oil and gas, coffee, tea, unprocessed rubber and timber which are practically of no relevance to GATT.⁴ As the composition of export changed from primary commodities towards manufactured products, however, involvement in liberalisation becomes crucial to Indonesia's economic development. Greater commitment has now been attached to the intra-ASEAN trade liberalisation as reflected in the adoption of a five-year liberalisation programme by the Manila Summiteers in December 1987. Together with other ASEAN countries, Indonesia has participated actively, that is with a willingness, to make certain concessions, in the Uruguay Round. Furthermore, Indonesia is actively involved in the various Pacific exercises oriented towards closer economic co-operation, with trade policy as one of its major components.

⁴On this see Suhadi Mangkusuwondo, Djisman S. Simandjuntak, and Sumarno Surono, "Trade Policy Options for Indonesia," in Mohammad Ariff and Tan Loong-Hoe (eds.), *The Uruguay Round: ASEAN Trade Policy Options* (Singapore: ISEAS, 1988), pp. 38-64.

SIGNS OF PERFORMANCE IMPROVEMENT

Pending an in-depth study on the impacts of the various reform packages, one can hypothesise that the reforms have worked as expected as can be seen in the improved performance of the economy in the last two years of Pelita IV. The growth rate of GDP tended to improve from 3.6 per cent in 1987 to an estimated 4.7 per cent in 1988. There are some signs that investment has been picking up. The trends of fixed capital formation has reversed since 1986. The amount of capital of both domestic companies (PMDN) and foreign companies (PMA) approved by the Investment Co-ordinating Board exhibited a rapid increase in 1987 and 1988 as can be seen from Table 8. Among the newly approved investment projects an increasingly large proportion is export-oriented, indicating the hope to take benefit of the changed comparative advantages especially in the Asia-Pacific and the incentives provided by the recent economic reforms which are oriented to export-oriented activities.

Table 8
THE AMOUNT OF INVESTMENT APPROVED BY
THE INVESTMENT CO-ORDINATING BOARD

	Domestic Investment (Rp Billions)	Foreign Investment (US\$ Billions)
1984/85	2,600	1.3
1985/86	3,700	0.9
1986/87	5,700	0.9
1987/88	12,200	3.1
1988/88*	4,800	1.9

Note: *April-August

Source: Central Bureau of Statistics, *Economic Indicators*, various issues.

The balance of payments position has also improved, if remains vulnerable to different kinds of uncertainties such as growth performance of the United States and Japan, Indonesia's major trading partners, and appreciation of the Yen, in which over 40 per cent of the country's external debts is denominated. It is true that total export has recovered only slowly. Given the economic

reform discussed earlier, but it is particularly relevant to underline here the good performance of non-oil export in general and that of the manufactured products in particular. In 1981, manufactured products defined broadly, that is, all products in SITC (*Standard International Trade Classification*) 5-8, accounted only for 5 per cent of total export. In the subsequent years, however, export of these categories grew rapidly from a small US\$1.1 billion in 1981 to US\$4.3 billion in 1987 and US\$3.7 billion in the first 8 months of 1988. This increase and the decline in oil export has resulted in an export composition at the end of Pelita IV which differs strongly from the one prevailing at the start of Pelita IV. At this juncture, one has to point out, however, to the fact that the expansion of export of manufactured products has relied heavily on a small number of products, namely textiles and garments, plywood, and non-ferrous metal. Furthermore, it is difficult to establish to what extent the increase in export of manufactured products has really been due to the trade policy reforms.

The import liberalisation and the promotion of export of manufactured products initiated in the last three years have also had their negative side as far as the balance of payments position is concerned. In spite of the austere fiscal and monetary policies, Indonesia's import has risen again from US\$10.7 billion in 1986 to US\$12.5 billion in 1987 and US\$8.7 billion in the first 8 months of 1988. This increase indicates a close relationship between import and export in recent years, a relationship which may intensify in the future as Indonesia relies more and more on manufactured products in generating foreign exchange. To produce a unit of trade surplus, Indonesia will have to export more than it did in the past.

Unlike trade in merchandise, trade in services has so far remained a source of major concern in Indonesia's balance of payments. Deficit in trade in services persists at the level of about US\$7 billion a year, meaning a current account deficit and a need for credit financing in the order of US\$2 billion annually which in turn has to rely primarily on net inflow of official capital. The sources of deficit in Indonesia's trade in services are well known. Given the large stock of foreign direct investment in oil and other sectors and a much larger stock of medium and long-term debts, a big amount of investment income is repatriated from Indonesia year after year. This item of services is expected to increase further in Pelita V irrespective of whether or not the Yen continues to appreciate. Another important source of deficit is shipping and other transportation. In 1987 for example, 157 million tonnes of cargo was moved out from and into Indonesia. Yet, the tonnage of Indonesia's shipping industries is not only limited, but was substantially reduced through the policy

of scrapping announced in 1985. Furthermore, expansion of tonnage is very slow as national shipping companies are required to procure new ships from local shipbuilders which have a very limited capacity. Shipping as a market is also highly regulated like in many other countries. The costs of using Indonesian ships rather than foreign ships are perceived to be high by shippers, giving rise to the poorly understood practice of using Singapore as a port of transshipment. Unless bold reform is introduced, trade in shipping will continue to record a big deficit. Even if such a reform is announced in the near future, it will take time for it to lead to a substantially smaller deficit in Indonesia's trade in shipping.

The area that has shown the best performance in the "export" of services is tourism. The number of foreign tourists visiting Indonesia in 1987 was 28.5 per cent higher than in 1986 and foreign exchange earning from tourism increased to US\$955 million from US\$591 million. The amount of both domestic and foreign investments approved by the Investment Co-ordinating Board also increased rapidly in 1987 and 1988. Approved foreign investment alone amounted to US\$355 million as compared to zero in 1985 and 1986.

Given such development in trade in merchandise and services, the current account continues to show a large deficit, if it tends to stabilise at the level of US\$2 billion annually. And while it is true that the financing of this deficit is somehow secured through the inflow of both private investment, especially foreign direct investment, and official capital, it continues to work as a major constraint to what Indonesia can do to stimulate the economy through more expansionary fiscal and monetary policies.

The positive picture that one can draw on the basis of growth, investment and trade performances in the last two years of Pelita IV becomes less encouraging once the problems of unemployment are taken into account. There are also other problems some of which will be taken up when the discussion turns to the major policy issues Indonesia has to address in the coming Pelita. Nevertheless, the improvement of performance in some areas, however weak it may be, provides some reasons to believe that the direction towards a more open economy that Indonesia has followed in the last three years or so does have a good chance to succeed, and that there is a need, therefore, to follow that direction in a more consistent way in the next Pelita.

PROSPECT FOR BETTER PERFORMANCE IN PELITA V

During the next five years, Indonesia has to cope with a wide range of difficult problems. Population is projected to increase to about 193 millions at the end of Pelita V implying a rapid increase in the demand for social services such as health. The expected increase in the labour force is even more staggering, namely 3 per cent per year or a total increase of about 11 millions in five years. The average level of education of this new entrance into the labour force will continue to be low. Professional background will remain overwhelmingly agricultural and the degree of geographical concentration remains very high. Taking into account the unsolved problems of underemployment, it becomes clear that Indonesia will face a very difficult challenge of employment generation during Pelita V. Unless progress is made in attacking the problems of unemployment, social unrest may accumulate in the course of Pelita V. In addition to unemployment problems, absolute poverty as one can see in the distress of slump areas in major cities, complaints about economic concentration, regional disparity, and outflow of economic resources due to foreign investment and the vulnerability of the economy to capital flights, increase the complexity of the problems that Indonesia has to cope with in Pelita V. Solution to these problems has to come, in the final analysis, from a strong improvement in the economic performance. Without the latter, it is illusory to expect, for example, a major success in the eradication of absolute poverty, though the burden of poverty can be alleviated to some extent through different kinds of redistributational mechanism as, among others, a government expenditure that attaches a greater priority to the provision of social services.

It follows that Pelita V has to perform much better than Pelita IV in terms of economic growth, if it is to provide a major contribution to the solution of the problems. In his report to the MPR (People's Consultative Assembly), the state body that is supposed to draw the policy guidelines on which a Five-Years Development Plan is to be based, President Soeharto has proposed an annual growth target of 5 per cent for Pelita V. In the meantime, this proposal has widely been treated as the official target and the Fifth Five-Year Development Plan is going to be worked out on the basis of this growth target of 5 per cent.⁵ However, this target appears too low on some accounts.

⁵How the Fifth-Year Development Plan is likely to look like, see Norihisa Sakurai, *Sources of Investment Finance During Repelita V. A Macro-Economic Approach*, a report prepared for the Department of Industry, Jakarta 1988.

First of all, a five per cent growth is inadequate in terms of the number of jobs that needs to be created. Some estimates made before the economic slowdown of the 1980s suggest that to generate a one per cent increase in employment Indonesia needs to grow by about 3 per cent, implying that an annual growth rate of 9 per cent will be needed in Pelita V to generate enough employment for the new job seekers alone. Secondly, the improvement of growth performance to about 4.7 per cent in 1988 suggests that a growth rate above 5 per cent in the next five years should be within reach, provided that the government is able to motivate all participants in the economy to multiply their efforts. Thirdly, the fact that Indonesia's neighbours in Southeast and East Asia can attain an economic growth rate of 8 per cent or even more, does not only tell that a high economic growth is not a "mission impossible" in the context of Asia, but it also opens up new opportunities for Indonesia to grow faster than it did in the last five years.

In terms of growth potentials, Indonesia has, indeed, nothing to complain about compared to most countries in the region. In the area of agriculture, there is a vast potential for expansion in non-traditional food crops, that is crops other than rice, cassava and sugar. The most promising areas include palm oil, rubber, cocoa, fruits and vegetables of various sorts, feedstuffs, chicken breeding, shrimp cultivation, tuna fishing and sea weeds, to mention only major examples where Indonesia has accumulated some production capability than can serve as a basis for expansion during Pelita V. While expansion in the oil and gas sector is severely constrained by the weak international demand, expansion in other areas of mining and quarrying is possible. The last few years have witnessed a rapid increase in the number of companies, both local and foreign, in gold exploration, though it remains uncertain to what extent this exploration can boost Indonesia's gold production in Pelita V. Ceramic is another area with a good prospect for rapid growth. Growth outlook in tin, nickel and copper appears, however, much less rosy partly because of the sensitivity of these minerals to progress in material technology pursued currently in the importing countries, especially the United States and Japan.

In terms of their contribution to total GDP, agriculture and mining and quarrying will continue to be the most important among all sectors in Pelita V. In terms of growth performance, these two sectors will, however, rank lower than other sectors given the overwhelming importance of rice in agriculture and that of oil and gas in mining and quarrying. Indonesia will be happy with a growth rate of 3 per cent in agriculture, but has to seek a much higher growth rate in manufacturing on which the future of its economic development is

perceived to be highly dependent.

Potential for rapid growth in manufacturing is difficult to assess. However, there are reasons to expect a much better growth performance of manufacturing in Pelita V than Pelita IV. First of all, the policy reforms of the 1980s have by and large transformed the manufacturing sector from import substitution to an export oriented one, even though some remnants of the import substitution policy remain in force. This change in market orientation is a fundamental one. While the growth of manufacturing in the 1970s and early 1980s was made dependent on domestic market which is not only limited but also highly vulnerable to fluctuation in the international prices of exported primary commodities, the export-oriented manufacturing industry of Pelita V can count on a practically unlimited global market. The possibility of exploiting any advantage to the fullest is now open.

The most obvious advantages Indonesia can enjoy during Pelita V lie in the abundance of natural and human resources. Therefore, expansion of the manufacturing in Pelita V is expected to be led by both resource-based and labour-intensive industries. Among the first group of industries canned fruits and vegetables, palm oil products, rubber products such as gloves and shoes, wood products such as plywood and furniture, processed rattan and ceramics are expected to grow fastest in Pelita V. Textile and garments are expected to continue to lead the labour-intensive industries. A big number of new products especially electronic and automotive components have, however, acquired some export capability. Though the contribution of these industries to both GDP and export will remain small, they are expected to rank high in terms of growth rate.

The expansion of the resource-based and labour intensive industries will create a new demand for different kinds of intermediate products, machinery and tools, the greatest part of which will continue to come from import. However, expansion of domestic production in this group of industries is expected to take place in some cases. The fertiliser and pesticide industries have a good prospect to expand and so has agricultural machinery which in turn provides a basis for expansion in the iron and steel industry. In a similar way, the expansion of the textile industry will also open up some rooms for expansion in the petrochemical industry in which two big projects were, in fact, approved in 1988 by the Investment Co-ordinating Board. The increase in import of capital goods in the last two years, the big increase in the amount of new investments approved and the rapid increase in export of manufactured products are good indications that the manufacturing sector can, indeed, grow much

faster than it has in the last five years.

The absolute size of Indonesia's services industry is big, though informal services seem to constitute the bulk of it, especially in construction, trading, and sea and land transportation. To a very high degree, expansion in this sector depends on how agriculture, mining and quarrying and manufacturing perform. Nevertheless, there are some services with a relatively good prospect for growth even if growth performance in the primary and secondary sector does not improve very fast. Tourism appears to have benefited greatly from the fact that Indonesia's neighbours are growing very fast. Both the number of tourist arrival and the amount of investment approved in 1987 and 1988 in tourism related areas especially hotels, suggest that this particular industry can count on a rapid growth during Pelita V with some spillovers on such supporting industries as food processing and handicraft. It is also possible to improve growth performance in ocean-going shipping and air transportation where Indonesia exhibits a big deficit so far, provided that the government is willing to deregulate these industries.

One can never overemphasise that growth performance during Pelita V is precariously dependent on export. Therefore, it is important to discuss briefly how Indonesians tend to perceive the international economic environment. First of all, growth performance in Indonesia's major trading partners is expected to weaken, but not to the extent that it would lead to an absolute decline in import demand. Secondly, the internationalisation of Japan is perceived positively and has in fact resulted in a substantial increase in Japan's import of manufactured products from Indonesia in 1987 and 1988. A consistent implementation of the Mayakawa Proposal is expected to lead to a continuous increase in Japan's demand for imported products. Thirdly, Indonesia has recently discovered new markets in the rapidly industrialising East Asia. Export to South Korea, Taiwan, and Hong Kong has expanded very fast in the last two years, though it concentrates on some primary commodities especially natural gas and plywood. In brief, there is no complaint that the external market is lacking, though some specific industries, notably the textile and garment industry, do worry about further erosion of the trading environment.

The textile and garment industry is concerned about repeated attempts in the United States to tighten the control of import irrespective of whether or not an exporting country belongs to major exporters. The palm oil industry is also worried about the campaign on the side of American soybean oil producers against palm oil. The campaign for intellectual property protection, freer trade in services and trade related investment measures as well as the

linkage these issues have with trade in merchandise, constitute another major concern. Finally, as a small trading country Indonesia is worried about the proliferation of bilateralism and regionalism partly because of the dilemmatic choice between bilateralism and multilateralism. The multilateral approach is now preferred among Indonesian policy makers, yet there are threats to this approach as clearly reflected in the disappointing record of the Uruguay Round. However, the international environment is expected to remain favourable to Indonesia as a newcomer in trade in manufactured products, even though erosion may occur in some areas. The shift in comparative advantages to the Asia-Pacific is expected to be strong enough to compensate for any deterioration of market access in the major trading countries. The major constraints to economic development in the next five years are, therefore, internal rather than external.

MAJOR POLICY ISSUES

Indonesia is currently confronted with a kind of dilemma as regards future economic reforms. On the one hand, the ability of the government and that of other participants in the economy, to absorb the various reforms is limited. This means that attention in the next five years should be concentrated on the consistent implementation of the reforms already introduced rather than on new policy initiatives. On the other hand, the incompleteness of the previous reforms is obvious. In investment policy or trade policy, as well as in sectoral policies, the past reforms have remained partial in nature. In the meantime, new issues arise in the wake of the reforms. Therefore, Pelita V may have to come up again with new policy initiatives in spite of the existing problem of having to digest numerous policy changes within a short period.

The following is an identification of areas where new initiatives appear to be needed. In the public sector economy, debt issues loom large. The viability of the present policy of servicing external debts according to schedules as a way of maintaining creditworthiness, which, in turn, is needed to secure new loans in the order of US\$6.5 billion annually, has been questioned occasionally. In this connection, availability of new credits from Japan with concessionary terms is of crucial importance. Experience in the last two years suggests that the strategy can work. However, any decline in Japan's aid commitment to Indonesia is likely to lead to a situation where Indonesia has no choice but to seek a debt renegotiation. Closely related to the heavy burden of external debt services, the option of financing deficit through domestic borrowing has also been discussed, though the viability of this option is also questionable

under the present circumstances.

The second issue of public sector economy relates to the high degree of centralisation in the government finance. Indonesia consists of 27 provinces, some of which have to take care of vast lands or waters with a poor infrastructure. The combined revenue of all provincial governments, including the revenue in the form of transfer from the central government, was as low as 11 per cent of the central government's revenue in 1987/1988. One can certainly argue that economic development in the provinces can continue to rely on direct funding from the central government. However, the direction towards a decentralised decision making process that the central government has taken through the various deregulation packages has to be reflected also in a decentralisation of the government system to ensure a greater effectiveness. The usual complaint about the lack of administrative capability on the side of the local government is not an adequate reason to maintain the high degree of centralisation in the government finance.

Thirdly, issues related to Public Sector Enterprises (PSEs) need to be given greater attention in the course of Pelita V. Considering the huge assets under their control and the strategic importance of the business lines they occupy, PSEs will continue to have a strong impact on the overall performance of the economy. Any inefficiency in the operation of Pertamina, Krakatau Steel and other monopoly-holding state enterprises is bound to be felt in a large number of industries. Efforts need, therefore, to be made to improve the economic performance of the PSEs. Transparency needs to be created or restored. A greater autonomy that delinks the PSEs from respective ministries should be granted to their management. Even privatisation appears to be needed, particularly in the cases of PSEs which were set up as commercial entities rather than a vehicle to cope with market failures. Many of Indonesia's PSEs, including some of the enterprises originating from the nationalisation of foreign companies in the late 1950s, are commercially oriented rather than otherwise.

As regards monetary policy, the challenge seems to be clear, namely that of lowering the interest rate without jeopardising the monetary stability. Attention needs to be concentrated on the relatively big difference between deposit and lending rates which in turn is widely believed to be caused by inefficiency in bank operation as reflected in the big amount of "bad debts." The next question is to what extent this inefficiency has something to do with the "oligopolistic" position enjoyed by the five big state banks which together have a market share of about 70 per cent in the banking sector.

In respect of trade and industrial policy, one issue that needs to be addressed is a demand for the removal of the remaining import monopolies, especially the ones in the iron and steel industry with their obvious adverse impacts on a wide range of industries in the downstream such as canned food. Question has also been raised as to the need to pursue self-sufficiency in crops other than rice as such a policy can indeed produce a boomerang effect if the protected crops are widely used as intermediate products as, for example, sugar, dairy products, especially milk, fruits and soybean. Furthermore, the proliferation of export ban on raw material as a way of forcing the growth of domestic processing is seen with a mixed feeling. On the one hand, diversification in the sense of processing prior to export is believed to have suffered from the refusal of importers to import processed products as long as they are allowed to import raw materials. On the other hand, there is a need to comply with GATT principles and rules to secure access to international markets, as well as to avoid the creation of unnecessary rent in favour of the privileged few in the domestic industry.

The Investment Priority List and the Deletion Programme, which requires investors to use locally made components according a time schedule prescribed by the Department of Industry, are potential areas for further reform in the investment and industrial policies. The extent to which these two measures have served their respective purpose has never been thoroughly studied. The very high import content of the electronic and automotive industries suggests that the deletion programme has not worked as expected. Indeed, it appears unrealistic to expect a rapid progress in this programme given the small size of the local market relative to the big number of competing products. Therefore, what seems to be urgently needed is a more open competition between different brands that ultimately drives inferior brands out of the market and provides a better opportunity for superior brands to engage in the programme.

Indonesia has, in a sense, engaged in industrial targeting as an important dimension of its industrial policy. In fact, the deletion programme can also be seen as an element of industrial targeting. In the traditional sense, however, the term industrial targeting is used to denote a development programme in the high-tech industries or frontier technologies with different sorts of support from the government such as protection against import, control of competition through entry restriction, government procurement and financial support.

Indonesia's industrial targeting may not fit very well into this definition. Its industrial coverage is primarily confined to industries or products which, in the context of global competition, do no longer belong to frontier

technologies. In terms of Indonesia's present level of technology capability however, the venture into the aircraft industry and the shipbuilding industry which constitute the core of the present industrial targeting in the Indonesian case, implies a technology "leapfrogging." The use of the terms is the more appropriate if one takes into account the country's involvement in such other high-tech industries as space technology with the stated objective of acquiring manufacturing capability in a not too distant future.

The emergence of Indonesia's industrial targeting coincided with the highly favourable resource position of the economy in the mid-1970s when the prices of primary commodities reached a historically high level which at that time was misunderstood as being irreversible. However, the resource position has worsened dramatically. The demand for transparency in the formulation and implementation of the industrial targeting has been growing, providing clues to some resistance against the projects chosen, and doubt as to the viability of the targeting itself, which so far relies totally on government funding. The outcome of this debate is difficult to predict. On the one hand the need for technology acquisition is felt stronger than ever before and so is the imperative to make use of the existing production facilities. On the other hand, the resource constraint continues to tighten. The financing of the government's development expenditures in the first year of Pelita V for example, is expected to rely primarily on project aids as government saving is dwindling. A thorough reassessment of the industrial targeting is, therefore, needed and should be included in the policy agenda of Pelita V.

There is another important issue that needs to be addressed urgently. In spite of the deregulation marathon of the last six years or so, the business community continues to complain about unfair business practices on the side of some powerful business groups who can enjoy the privileges of having direct access to the "centres" of economic policy making. However, nepotism in the widest sense of the word is only one part of what is included in the terms "unfair business practices." The formation of cartel, merger, fusion, the proliferation of conglomerates or business "groups" as they are commonly known, discrimination based on primordial linkages, counterfeiting, hijacking of employees, hidden discounting, substandard treatment of workers and many improper practices are also of direct relevance. Therefore, deregulation of the kind that the government has initiated so far, are not sufficient to create a condition that is favourable for the promotion of fair competition which in turn is needed to improve the performance of the economy, especially in the longer term. Pelita V is therefore, expected to include in its policy agenda a competition policy that may help to reduce unfair business practices and the

dead-weight costs they impose on the economy.

It remains to be seen whether or not Pelita V will turn out to be as successful as Pelita IV in terms of new policy initiatives. The improvement in the economic performance in the last two years of Pelita IV may strengthen the confidence of the government to stick to the direction towards a freer economy. However, resistance from vested interest groups who in the meantime have ventured into a growing number of sectors is very likely to force the government to make compromises at the cost of its own credibility, though not necessarily to the extent that would severely damage the economic performance of Pelita V.

Performance of Indonesia's Agriculture: Food Self-sufficiency and Beyond

I. TUBAGUS FERRY

INTRODUCTION

The agricultural sector remains important to Indonesia's economic development although sectoral contribution to the country's economy has become more diversified over the past twenty years. It is the sector that supplies the country's need for food, provides employment for the greatest part of its population and contributes greatly to its non-oil export. It accounted for over 50 per cent of GDP in the early 1960's to remain almost 25 per cent at present. In 1985 it accounted for 55 per cent of total employment.

Based on the above-mentioned indicators, many agronomists believe that Indonesia's economy has undergone structural changes from being purely agricultural to an industrially oriented one. But the fact that in real terms the contribution of agriculture decreased by only 3 per cent from 1978 to 1985, and that the share of food crops in the agricultural output increased rather than declined suggests that the structural change was rather limited in magnitude. One of the reason is the declining prices of agricultural commodities relative to those of other commodities.¹

The importance of agriculture to Indonesia's economic performance in recent years was reflected in the fact that during the period of world recession (1981, 1982 and 1983), the growth rate of the agricultural sector was greater than that of manufacturing, namely 2.14 and 1.22 per cent respectively be-

¹Ministry of Agriculture, Republic of Indonesia, *Statistical Information of Agricultural Commodities* (Jakarta: June 1983).

tween 1981 and 1982. The same applies to the period between 1982 and 1983 when the agricultural output grew by 4.8 per cent while that of manufacture grew only by 2.16 per cent.² In other words during the period when the overall growth performance was weakening the agricultural sector exhibited an improved growth performance though not by big margin. For that reason, the agricultural sector in Indonesia has often been called the "saviour" of the entire economy.

This paper attempts to present an analysis on the performance of Indonesia's agricultural sector in recent years, particularly concerning factors which have led to Indonesia's success story in agricultural development. The experiences in the last decade will be scrutinised, both the positive and negative sides will be highlighted and opportunities for and constraints to future developments will be identified.

ACHIEVEMENT IN FOOD SELF-SUFFICIENCY

The greatest achievement in the agricultural development in Indonesia is perhaps the successful programme in increasing food production, especially rice, which led to rice self-sufficiency in 1984. This achievement is remarkable in view of the fact that since the end of World War II, a high rate of population growth has implied an increasing demand for food which in turn has necessitated an increase in food production.³ Hence many developing countries, including Indonesia, have had to pay great attention to the attainment of food self-sufficiency.

Many factors have contributed to the success of agricultural development in Indonesia. Among them is the agricultural policy in general and food policy in particular. The policy involved can generally be classified into two basic strategies, namely resource and technology based strategies.⁴ Given the various constraints facing Indonesia's agricultural development such as land unavailability or shortage, backward cultivation methods and low level technology, the

²BPS, *Indikator Ekonomi*, various edition.

³See the importance in developing food production related to the green revolution in Keith Griffin, *The Political Economy of Agrarian Change* (London: Mac Millan, 1974).

⁴See Sudarsono Harjosukarto, "Indonesia's Food Policy: Learning a Lesson from a Success-story," *Indonesian Quarterly*, Vol. XIII, No. 2 (April 1985).

adoption of technology based strategy appears to be more viable than the former.

The Production Structure of Indonesia's Agriculture

The cropping pattern of Indonesia's food agriculture can be seen in Appendix 2. Among the food crops, paddy, corn and cassava are the dominant ones with a combined share of more than 80 per cent of the total harvested areas in 1987. One can also see from Appendix 2 that the cropping pattern in Indonesia remained basically the same during the last 5 years with emphasis on the expansion of rice production to reach and maintain rice self-sufficiency through extensification and intensification programmes. However, the high priority attached to the production of rice is believed to have created the achievement of the objective of food diversification programmes.

Being the staple food for the majority of Indonesians, rice is consumed by more than 97 per cent of Indonesia's households. About 87 per cent of rice fields are irrigated, of which 57 per cent are located in Java. However, the growth of harvested areas in Java is much lower than that of the other islands, since in Java, cultivated land has been farmed very intensively while there is only very few remaining for extensification.

The remarkable increase in rice production from 17.9 million tonnes in 1979 to 27 million tonnes in 1986 has resulted in rice self-sufficiency which has been announced, with some pride, as Indonesia's most outstanding performance. But, as shown in Appendix 3, rice production growth tend to slow down. A decrease can be observed in the total harvested areas in 1987, creating problems in maintaining rice self-sufficiency in the future. It is also important to note that the per capita consumption of rice increased from 116 kg in 1976 to more than 130 kg in 1980's. This rapid increase has also been considered as another factor which may make it difficult for Indonesia to maintain rice self-sufficiency and to diversify food consumption successfully.

After rice, corn is the main staple food cultivated in Indonesia. It has been considered inferior to rice and, consequently, a considerable shift from corn to rice has occurred with the rise of income. The greatest part of corn production is consumed by the rural population. However, the consumption of sweet corn has increased, recently in urban areas as a result of an increase in the demand for additional food. Self-sufficiency in corn has not been achieved. Its import is still greater than its export though the share of import in consumption is ap-

parently small. The trends of corn production are also indicated in Appendix 3.

Soybeans consumption is largely concentrated in the urban areas, especially in Java. Although the production of soybeans has remarkably increased, a large quantity of soybeans still has to be imported to satisfy the domestic demand (see Appendix 3).

As is the case with corn, soybeans are usually planted after the first or the second rice crop as part of crop rotation. In many areas, farmers do not grow soybeans with the same intensity as they do with rice or corn. The quality of the seed varies from one to another which may result in the inconsistency in the quality of the product. For the same reason, its production growth has not been as spectacular as in the cases of rice and corn.

Cassava is basically a rural food. Its consumption in rural areas is four times as large as that in urban areas. It is also considered as inferior to rice, but domestic demand for industrial purposes is growing rapidly. Although the area harvested declined slightly, the yields tended to increase at a remarkable rate. The amount of export has not reached the EEC (European Economic Community) quota partly because of the expanding domestic demand as revealed in Appendix 3.

Sugarcane production has increased in recent years, but has remained below domestic demand. In addition, the domestic price in 1985 was over two times the world price level. It is rather difficult to explain why Indonesia cannot produce sugar at a lower unit cost. One of the reasons appears to be high cost economy and managerial inefficiency within the system of sugarcane plantations. At the beginning of the first Five Year Development Plan (Pelita I 1969), the per capita consumption of sugar was 6.68 kg/year. It increased to 11.24 kg/year by the end of Pelita II (1978) and 11.93 kg/year in 1987. It is likely to increase further in the future as income rises. Thailand and Pakistan, for example, had a per capita consumption of sugar of 14.1 kg/year and 14.6 kg/year in 1987.

Originally it was expected that self-sufficiency in sugar would be achieved in 1984 at the same time when rice self-sufficiency was attained. However, the volatility of sugar production due to managerial weaknesses had resulted in the need to import in 1986 and 1987 (see Appendix 3). In 1975, the decree on Smallholder Sugarcane Intensification (*Tebu Rakyat Intensifikasi*) set the targets for sugarcane planting and the produce to be delivered to the

designated sugar mills. But, of all the commodities grown in irrigated areas, sugarcane has turned out to be the least competitive. Yet, farmers have still been required to cultivate it in order to fulfill the objective of increasing self reliance in sugar. The policy is said to have hurt farmers in the form of reduced income and employment, while the consumers have had to pay a price higher than that of the world market.

Animal husbandry has also been developed through intensification and extensification programmes. The targeted aim is to increase the animals in terms of both quantity and quality. The development of this subsector has increased the farmers' income at a time when they can no longer rely completely on agricultural commodities as their prices has declined in real terms. A remarkable growth rate has been recorded, for example, in the production of meat and eggs, which increased by about 150 per cent from 1983 to 1987, while that of milk increased by 200 per cent.⁵ However, export of livestock and livestock products has declined slightly as a result of an increase in domestic demand.

POLICY INSTRUMENTS

Rice is not just an ordinary commodity to most Indonesians. Self-sufficiency in food, therefore, is considered to be attained only when self-sufficiency in rice is achieved. Any shortage of rice can easily become a socio-political and security issue. As a consequence, the government has put a strong emphasis on the development of rice production as reflected in various policy interventions. The most important policies adopted includes planted area targeting, rice price maintenance through a buffer stock system, production input subsidisation particularly with regard to fertilisers and pesticides and institutional development. The implementation of the policy requires a considerable number of decrees and regulations. For paddy and such secondary crops as corn and soybeans and smallholder sugar, a national production target is set, which is then divided into targets at the provincial and district levels. Local governments determine to some extent the cropping pattern. In addition, technical packages consisting of seed, credit, pest-control, marketing etc, as well as institutional arrangements are also prescribed. The result in terms of output turns out to be impressive, but the policy involves various types of costs that need to be discussed thoroughly for the purpose of finding possible improvements to the overall policy.

⁵See the Supplement of President's Speech to Parliament, March 1 1988.

Fertiliser Subsidy

Fertiliser subsidy accounted for almost 2.5 per cent of the total government expenditure since 1980.⁶ Given its large size, fertiliser subsidy has become an important issue in recent policy debates. Firstly, the contribution that the subsidy given to rice production has been questioned. It is generally believed that the production of rice in an intensive cultivation is very sensitive to fertiliser treatment. Based on data published by the Central Bureau of Statistics⁷ one can estimate that without fertiliser subsidy the supply of rice in 1987 and 1988 would have fallen short of demand, making the import of rice necessary. Since food self-sufficiency in the Indonesian case is primarily meant as rice self-sufficiency, the government has to provide a considerable amount of subsidy in order to maintain Indonesia's rice self-sufficiency. In 1985, for example, the actual subsidy exceeded its budget target⁸ while tax revenue decreased as a result of the decline in oil prices.

The second issue relates to the effect of fertilisers subsidy on farmers' income. Considering that a one per cent change in the amount of fertilisers input results in 0.116 per cent in farm output (dry paddy), and taking into account the price of the output, of fertilisers and other inputs, one can calculate that the corresponding increase in the monthly income is only 8 per cent.⁹

The third issue concerns the inefficiency in the distribution of fertilisers from the factory to farmers. In 1986, the amount of fertiliser subsidy was almost equal to the amount of factory prices.¹⁰ The inefficiency of distribution is believed to have led to the fact that fertiliser subsidy induces only a very small increase in farmers' income.

⁶The average fertilisers subsidy between 1980-1987 was about 450 billion Rupiahs annually.

⁷*Struktur Ongkos Usaha Tani Padi dan Palawija*, for further information see I. Tubagus Fery, "Subsidi Pupuk dan Kesejahteraan Petani," CSIS, forthcoming.

⁸The subsidy was increased until almost 236 per cent of its target in APBN (the State Budget) and it might be the result of the application of new highly intensive cultivation methods, see *ibid.*

⁹*Ibid.*

¹⁰The average factory price of fertiliser was about Rp 100/kg, the distribution activities cost approximately Rp 100/kg. Because the average retail price was set at Rp 100/kg, the government has to provide subsidy worth Rp 100/kg.

Pesticides Subsidy

The subsidy of pesticides to farmers is estimated to be about 42 billion rupiahs in 1986/1987. In terms of market prices the subsidy amounted to 40 per cent while the retail price or the price paid by farmers accounted for the remaining 60 per cent. Since pesticides account only for a small proportion of the production cost in Central Java, where the intensity of the use of pesticides is probably the highest, pesticides subsidy may have not increased farmers' income significantly, but seems to have encouraged an overuse of pesticides.

Ironically, the overuse of pesticides has wiped out not only the pest but also its predators. This came as a surprise when in 1986 a major rice pest caused by the brown plant hopper destroyed at least 59 million hectares of farm land compared to 19 million hectares in 1984. The damage was due to the resistance of the brown plant hopper to pesticides and the vulnerability of the rice variety chosen and supposed to be resistant to the pest. The government became aware of the problem at an early stage and in November 1986, the President issued an instruction banning the use of 57 different pesticides on rice crops and recommending the use of narrow spectrum insecticide instead.

Irrigation

The average rice yield on irrigated land is more than double that on the unirrigated. There is more than 5.2 million hectares of irrigated land in Indonesia, most of which is used for rice production. The World Bank estimated that about 16 per cent of the increase in rice production during 1970's was due solely to the expansion and improvement of the irrigation system, 9 per cent on account of the improvement of rice varieties and fertilisers used and the rest was due to the interaction of these variables.¹¹

Of all the farm inputs in Indonesia's agriculture, especially in the subsector of food crops, water is the most heavily subsidised. The average operational, maintenance and annualised capital cost of a medium-sized irrigated project is estimated at about Rp 187,000/ha of which less than 13 per cent is recovered through direct charges and property taxes. The implicit subsidy amounts therefore to Rp 165,000/ha or Rp 660 billion for the 4 million hectares of government-financed irrigation.¹¹ However, the irrigation programme, also, has to be adjusted to the budgetary constraint faced by the government. The development expenditure of the Directorate General of Water Resource

¹¹Estimation by The World Bank.

Development (DGWRD) in fact declined by one third in 1986/1987. This explains partly the decrease in new irrigated areas from 449.2 thousand hectares in 1983 to only 107.3 thousand hectares in 1986/1987.

The budgetary constraint has also affected the structure of development spending and the progress of irrigation works as can be seen in Appendix 4. The spending on irrigation operations and maintenance seems to have been maintained at about 40 billion rupiahs in spite of the decline in total development expenditures by one-third in two years. In 1986/1987, the DGWRD seemed to have paid much more attention to the improvement of irrigation systems rather than to rehabilitation programmes, especially outside Java. This change in the pattern of development expenditures resulting in the physical progress may create many problems in maintaining rice yields.

Price Policy

The price policy adopted by BULOG (National Logistics Agency) of Indonesia has provided several benefits, especially in protecting the domestic market from fluctuations in world prices of rice. BULOG has also been given the exclusive authority to import and distribute sugar, wheat and soybeans and to implement price support for maize and peanuts. The highest priority, however, is attached to rice. To maintain the ceiling and floor prices of rice, BULOG has run an increasingly large deficit in recent years. The deficit in 1984/1985 was as small as 26.7 billion rupiahs, but in 1985/1986 and 1986/1987 it increased rapidly to 112.6 and 123.4 billion rupiahs respectively. This increase was due almost entirely to the build-up of stocks, mostly of rice, derived from domestic production.¹² Had BULOG been allowed to import rice when its world price in real terms declined during 1984-1986, the deficit would not have been as great as it actually was.

Another effect of the price policy is the decline in the domestic real prices of rice. This decline might have contributed to the fact that the increase in farmers' income remains small, notwithstanding its rapid growth. Rural farm income has increased from 18 per cent of total income at the end of 1970 to 29 per cent in 1983. Furthermore, farmers can no more rely solely on their farm output as their single source of income, as will be the case if farming continues

¹²According to The World Bank, the deficit represents the difference between the "book" value of BULOG's acquisition and sale of a commodity, as estimated by the Department of Finance.

to be limited to food crops.¹³ For this reason the government has provided a huge input subsidy to maintain a certain level of farmers' income and, thereby, to stimulate production. However the increasingly tight budgetary constraints will necessitate a decreased reliance on subsidy. The rice economy which has been very dominant in food policy will no longer provide the same dynamism to agricultural growth and farmers' income as it did in the 1970s.

Trade Policy Elements

Agricultural commodities have always enjoyed a high level of protection in Indonesia. Tariff and different types of non-tariff barriers are imposed on the import of agricultural commodities. The average tariff rate is relatively high and it differs considerably from one sector to another. Appendix 5 shows that tariff rates on food and live animals together with beverages and tobacco were as high as 44 per cent and 49 per cent respectively in 1980. However, it is rather difficult to judge as to whether or not the high tariff rates in Indonesia have produced the intended effects on the expansion of domestic production. Tariff is of no relevance as a protection instrument in the case of many agricultural products because of the existence of an import ban.

The illustration of non-tariff barriers can be seen in Appendix 6. Among the different types of non-tariff barriers import bans and state trading have been used more frequently as compared to restrictive licencing and quota. In fact, Appendix 6 does not tell us about the proportion of imports under non-trade barriers. However, it does provide some information about non-tariff barriers in Indonesia, not to speak of the extent to which they have curtailed imports. Non-tariff barriers are used more frequently in basic manufacturing, followed by agriculture and machinery, transports and telecommunications as a group. Furthermore the pattern of non-tariff barriers in agriculture differs from that in manufacturing. Food, beverages and tobacco have been much more influenced by import bans while non-tariff barriers in manufacturing are mostly in the form of restrictive licencing. In other words, agriculture appears to be the most protected sector in Indonesia's economy. In addition, the trade liberalisation initiated since 1986 has not affected the agricultural sector (see Appendix 7).

¹³See for example Faisal Kasryno, *Prospek Pembangunan Ekonomi Pedesaan Indonesia* (Jakarta: Yayasan Obor Indonesia, 1984) or Piet Rietveld, "Non Agricultural Activities and Income Distribution in Rural Java," *Bulletin of Indonesian Economic Studies*, Vol. XXIII (December 1986).

For the time being the problem concerns with the question as to whether the trade barriers are viable and efficient to protect agriculture, which has enjoyed the status of an infant industry. It is rather difficult to judge considering the fact that in almost all developing countries the agricultural sector are very much protected. On the one hand it is believed that protection is very important to domestic agriculture, but on the other hand the protection policy sometimes ignores comparative advantage considerations and results in some inefficiencies.¹⁴ With reference to IMF projection that there will be a decline in world prices of food commodities in the next couple of years, and considering the comparative advantage in maintaining a national food stock which may reduce the deficit that BULOG has for maintaining self-sufficiency in rice, it is believed that protection in agriculture can be reduced by implementing less protective instruments, and more quota and import bans instead.

Other Instruments

Farm credit facilities with potential interest rates has always been among the important instruments of Indonesia's agricultural policy. The average interest rate paid by farmers is only about 12 per cent, while the average lending rate in the formal financial sector is 20 per cent or over. There are several types of credit available to farmers such as *Kupedes* and *Bimas*.¹⁵ The former is believed to have been more successful than the latter in mobilising rural financial resources and in allocating credits to more profitable activities. There are however problems in rural farm credits. Allocation of credits is based on a set of criteria which is not clearly defined. Misallocation of cheap credits seem to a great extent to have taken place. Sugar production for example has accounted for only 3 per cent of the total output of crop products, but received more than 20 per cent of the total outstanding credits to agriculture.

Of great importance as an instrument of agricultural policy is also research and development programmes. Success story Indonesia's agriculture would not have been possible had there been no improved seeds, improved methods of cultivation and improved post-harvest handling, which all rely on research and

¹⁴Such as, the implementation of an import ban for a certain food commodity when its world price declines.

¹⁵*Kupedes (Kredit Umum Pedesaan)* is an rural credit offered with an interest rate of 18 per cent, which is the average national level. *Bimas (Bimbingan Massal)* is a rice culture development system based on irrigation and information to groups of peasants on planting techniques, in which a subsidised credit is provided for to buy subsidised fertilisers and pesticides.

development. However, the budgetary constraints facing the government in recent years have also been felt in research and development as well as in the extensification programmes. In 1987, the total expenditure on agricultural research accounted for only 0.3 per cent of agricultural GDP while the ideal ratio is supposed to be in the order of 2 per cent.¹⁶ Another problem relates to the fact that research and extension activities lay too much emphasis on rice, while in fact the research and development efforts in other crops are needed more urgently. The yields of corn and cassava need to be improved, at least to a level which is comparable to the yields attained by neighbouring countries. It sounds strange that the research expenditure of cassava is relatively very small compared to that of rice while in fact Indonesia has been one of the biggest cassava producing countries. Furthermore concentration of research expenditures on rice has by default meant a concentration on Java while the improvement of soil fertility and irrigation system outside Java appears to be important as a way of enlarging harvested areas.

FUTURE FOOD MARKET

Estimation of Individual Items

Appendix 8 shows an estimation on Indonesia's rice market in the near future. Assuming a population growth as estimated by the Central Bureau of Statistics, a two per cent increase in per capita rice consumption annually, and the need for a national stock of 2.5 million tonnes, the total demand of rice in 1988, 1989 and 1990 may amount to 27,521, 28,557 and 29,636 thousand tonnes respectively. If self sufficiency is to be maintained, rice yields have to increase at a rate between 3 and 4 per cent annually. The increase in rice production per hectare has to be sufficiently high to compensate for the expected one per cent annual decrease in harvested areas. This decrease in harvested areas is very likely to occur as a result of the decreasing irrigation spending which has been mentioned earlier.

However, maintaining the improvement in rice yields by 3 to 4 per cent annually is not an easy task. The various constraints to be faced have been discussed earlier. Given the very small fertiliser elasticity of production¹⁷ the

¹⁶The World Bank estimation.

¹⁷Fertiliser elasticity of production is the percentage increase in production due to a percentage increase in production see further, Tubagus Ferry, "Subsidi Pupuk."

fertiliser needed to increase rice yields by 3-4 per cent annually would be huge. The same applies to pesticides subsidy and irrigation expenditures. Facing these difficulties, there are two options available to the government. The first is to maintain rice self-sufficiency by keeping rice yield sufficiently high to satisfy the increasing domestic demand, but taking thus the risk of having to allocate an increasingly big proportion of limited resources to agricultural development, even if efficiency can be improved in many ways. The second is to develop a more flexible rice self-sufficiency in the sense that production-consumption ratio does not need to be 100 per cent.

Food self-sufficiency is certainly of great importance to national security. However, a more flexible definition of food security would at least have to take into account two aspects. Firstly, food security does not necessarily mean a dependence on a single food crop. Secondly, food security is more directly related to food availability than to domestic production. In other words, food security can rely at least partially on import, particularly if the comparative advantages of the country concerned tend to lie elsewhere than in the staple food subsector.

Per capita consumption of *sugar* is projected to increase at least by 2-2.5 per cent a year in the next couple of years. Given the number of population, the total demand in 1989 and 1990 will be around 2,494 and 2,593 thousand tonnes respectively (see Appendix 9). The increase of actual demand may turn out to be even higher, considering the fact that per capita consumption (11.93 kg/year) is still lower than the average consumption in developing countries of 15 kg/year in 1987 and the positive income elasticity of sugar consumption.

Sugar supply in Indonesia is very difficult to predict. Sugar production is very sensitive to weather conditions and the management of the plantation system. In fact, the actual sugar production has never reached the level of planned production in recent years. The production of sugar in the near future is also predicted to continue to be short of domestic demand. Harvesting areas in 1988 is expected to be only 50 per cent of the target mainly because of a prolonged drought in 1987. Furthermore, the production cost of sugar, especially with regard to the part of the planting sugarcane has been increasing due to poor management and other inefficiencies. It is worth noting at this juncture that sugarcane is very sensitive to managerial capabilities. The exact time schedule for planting and harvesting affects, for instance, to a very high degree, the amount of sugarcane to be harvested and the sugar content of the cane. Co-ordination between plantation unit and sugarmill is also crucial as any delay in milling harvested cane may prove disastrous in terms of sugar out-

put. The recent increase in production cost has only partially been related to the increase in fertiliser use and the 50 per cent increase in labour cost for planting and harvesting activities.

The floor price of sugar is set at about Rp 500/kg and the average retail price in 1988 is about Rp 800-Rp 900/kg. Even with world price tending to increase to about Rp 420/kg following the stock decrease in exporting countries,¹⁸ Indonesia's domestic price is still higher than the world price. Yet, changes in the structure of the world sugar market characterised by the replacement of sugar by high fructose corn syrup¹⁹ may result in an even lower price in the future or a growing gap between the domestic prices in Indonesia and world prices. There is a need to import as a policy option. The fertile areas which so far have been used for planting sugar-cane can then be used for planting rice, which means that at least part of the need for an increase of harvested areas land for rice planting can be met. However, sugar imports which in 1988 and 1989 is estimated to amount to 150,000 tonnes and 200,000 tonnes respectively will increase further.

The future domestic market of soybeans may look very much the same as those of sugar and rice. The increasing demand for soybeans is closely related to the increasing demand for feedstock as the population of livestock has increased sharply in recent years. On the other hand, the yield of soybeans in Indonesia is still very low by international standards namely 1 tonne/hectare in 1987 as compared to 2-3 tonnes/hectare in the United States. While the production of soybeans has increased it cannot keep pace with the demand, implying that a big import is still needed.

It follows that the future market of soybeans in Indonesia will greatly depend on the fluctuation of world prices. As a matter of fact world prices fluctuated in 1988 with the highest price occurring in June-July 1988. The price in October 1988 was about Rp 550/kg and BULOG sold the imported soybeans at a price of Rp 725/kg. The selling price was still lower than that of domestic soybeans which ranged from Rp 800 to Rp 900/kg in spite of the fact that the quality of imported soybeans is better than that of domestically produced soybeans. However, what is of direct relevance to import in the near future is the long drought of 1987, which is expected to bring about an increase of import to 700,000 tonnes in 1988. As for 1989 and 1990, imports are expected to decline to about 400,000-500,000 tonnes.

¹⁸See IMF Publication, *Primary Commodities, Market Development and Outlook* (May 1988).

¹⁹See *ibid.*

The domestic demand for corn has increased as a result of the increasing production of feedstock in recent years. However, the actual production of corn too has never reached the planned production in 1987. The main problem is the low level of yield of less than 2 tonnes/hectare while the desirable yield should be more than 4 tonnes hectare. For this reason corn self-sufficiency is unlikely to be attained by the end of Pelita IV as originally expected. Based on recent experiences the import of corn is expected to amount to 50-100 tonnes per year in the next couple of years. The corn policy should emphasise on research and extension activities so as to increase the yields per hectare to the desired level.

As one of the cassava exporting countries, Indonesia seems to have no problem in maintaining self-sufficiency in cassava. Assuming its sustainability the great increase in cassava production in recent years may result in an increase of export in the near future. Indonesia is believed to be in a position to utilise fully the EEC quota by the forthcoming two years. If there is an excess supply in the domestic market as the supply of cassava exceeds its export quota, greater opportunity for the involvement of the private sector should be provided, especially in the area of cassava based industry.

Consequences

The important challenge in Indonesia's agricultural policy in the near future is the development of a more efficient and diversified agriculture which has the capacity to respond to changing market conditions. Facing this challenge Indonesia can rely on favourable endowment factors such as the relatively low labour cost, fertile soil, especially in Java, varying agro-climatic condition allowing the planting of a wide range of crops. According to the World Bank, Indonesia has comparative advantages in producing rice, corn, soybeans and all tree crops but not sugar. However, the tapping of the potential will greatly depend on the flexibility of the policy to adapt to the changing environment, with due account to the macro-economic constraints plaguing the country currently.

The strategic policy is the diversification of both the consumption and production of food. Dependency on rice has to be reduced while comparative advantages in other crops need to be exploited. Such a shift in policy will minimise vulnerability to fluctuation in rice production. It may also turn out to be of great help to the promotion of non-oil export. This is not to deny that

diversification policy has been implemented since 1970's,²⁰ but the result has not turned out to be significant yet.

To support the diversification programmes, research and extension programmes in food crops other than rice should be intensified in the future, especially as regards corn and soybeans. Such research and extension programmes would reduce the cost and make the production of corn and soybeans as beneficial as that of rice. Since the fertile soil areas in Java are limited the allocation of land to more productive uses is very important. For example, the shifting from sugar production to rice production in intensively irrigated areas in Java would increase not only rice production but also the farmers' income.

POLICY DIRECTION

Given the many constraints facing Indonesia, the continuation of the past agricultural policy will have at least 2 consequences. Firstly, continuous subsidisation of inputs for the sake of the high yields of rice will overstretch the budget. The inefficiencies within the agricultural sector will also persist. Secondly, the attempt to diversify both consumption and production is unlikely to succeed.

A new concept of food self-sufficiency has to be developed as food security need not to rely on a single crop and domestic production is only part of the food supply, though, indeed, a very important one. This redefinition of self-sufficiency will become very important in view of the fact that input subsidies may have to be reduced in the years to come with the probable impact of a decline in production.

The priority in the near future should be attached to the reduction of subsidies to fertilisers and pesticides. To avoid a decrease in farmers' income and to minimise the increase in the price of output, efficiency within the sector has to be improved. This can be facilitated by providing the opportunity for a wider participation of the private sector in the distribution of farm inputs such as fertilisers and pesticides and the trading of output.

In terms of price policy, BULOG has an important role to play in maintaining an equilibrium in the rice market. Nevertheless, BULOG's role in intra-season price stabilisation of rice and intra-season stock holding could be

²⁰For example one of the consumption policies announced in 1979 was INPRES 20/1979, which is concerned with the food consumption diversification.

reduced further if the price band is widened, making it profitable for the private sector to expand its stockholding activity. One of the possible consequences is an increase in the price of rice which is politically undesirable as it may lead to an inflationary process. However, some empirical studies suggest that the instability of rice prices has not been the dominant factor behind inflation in Indonesia.²¹

The process of crop diversification will be better facilitated by a greater use of price support, rather than by crop targeting and regulation. At present Indonesia can be competitive with regard to import in a range of field or food crops such as rice and corn and has a strong comparative advantage in the export of commercial crops such as rubber, palm oil, and coffee. It can never be overemphasised that the administrative regulation of the cropping patterns as an instrument of the diversification policy leads to the misallocation of land and other inputs. One can learn from the experiences of the NESS or PIR (Perkebunan Inti Rakyat).²² Optimal cropping pattern is strongly affected by either location, agronomic consideration or available technologies. For this reason, the agricultural policy should allow farmers greater latitude to choose their own crop patterns in response to market signals. Should intervention be needed, the instruments should be price support rather than area and crop targeting.

²¹See Bungaran Saragih and SHM Tampubolon, "Pertanian dalam Pembangunan Ekonomi Selama Pelita V: Sumbangan Pikiran dalam Rangka Desentralisasi, Debirokratisasi dan Dereglasi," paper presented in economic discussion organised by *Suara Pembaruan*, April 1988.

²²Nucleus Estate Smallholders System (NESS) is the programme which is to be carried out by transferring recent and relatively sophisticated technology from nucleus estate (large estate) to the surrounding farmers and by providing the processing and marketing facilities to farmers. In fact, as a result of management which is strictly regulated in the mechanism of NESS, farmers have received less benefits than it is supposed to. For further illustration see for example Saragih and Tampubolon, "Pertanian dalam Pembangunan Ekonomi Selama Pelita V," paper in economic discussion organised by *Suara Pembaruan*, April 1988.

Appendix 1

GROSS DOMESTIC PRODUCT
(Per Cent)

SECTOR	1978		1985	
	Constant Price 1973	Current Price	Constant Price 1973	Current Price
Agriculture	33.0	30.5	30.0	23.5
- Food Crops	(58.5)	(59.5)	(62.6)	(62.4)
- Non-Food Crops	(12.4)	(12.0)	(12.7)	(13.5)
- Estate Crops	(6.7)	(6.0)	(8.7)	(2.8)
- Livestock & Livestock Prod.	(5.9)	(6.9)	(6.3)	(10.2)
- Forestry	(11.2)	(9.7)	(4.2)	(4.3)
- Fisheries	(5.3)	(5.9)	(5.5)	(6.8)
Mining & Quarrying	11.0	17.6	6.8	16.2
Manufacturing	12.4	10.0	16.9	13.5
Electricity, Gas & Water	0.6	0.5	0.9	0.8
Construction	5.6	5.6	5.7	5.3
Wholesale & Retail Trade	16.2	15.7	16.3	15.4
Transport, Storage & Communication	5.2	4.4	6.2	6.5
Finance, Insurance & Real Estate	4.7	4.9	5.6	5.5
Community & Social Services	11.3	10.8	11.6	13.3

Source: BPS, *Indikator Ekonomi*, various editions.

Appendix 2

CROPPING PATTERN OF INDONESIA'S AGRICULTURE
(Total Harvested Area)

Commodity	1983	%	1985	%	1987	%
Rice	9,162	61.3	9,902	63.9	9,865	61.7
Corn	3,002	20.1	2,440	15.7	2,769	17.3
Cassava	1,221	8.2	1,292	8.3	1,186	7.4
Sweet Potatoes	280	1.9	256	1.7	208	1.3
Peanuts	481	3.2	510	3.3	573	3.6
Soybeans	640	4.3	896	5.8	1,150	7.2
Sugarcane*	163	1.1	200	1.3	237	1.5
Total	14,949		15,496		15,988	

Source: Supplement to the President's Speech before Parliament, March 1 1988.

* Harvested Areas of TRI (Tebu Rakyat Intensifikasi), the system of smallholders' sugarcane plantation in Indonesia.

Appendix 3

TREND OF THE MAIN FOOD CROP PRODUCTION AND TRADE

	1983	1984	1985	1986	1987
RICE					
Area Harvested (000 ha)	9,162	9,764	9,902	9,988	9,865
Yields (kw rice/ha)	2.62	2.66	2,70	2,70	2,76
Production (000 tonnes)	24,006	25,932	26,542	27,014	27,253
Import (000 tonnes)	1,160	-	-	-	-
CORN					
Harvested Area (000 ha)	3,002	3,086	2,440	3,143	2,769
Yield (kw/ha)	16.94	17.13	17.74	18.84	19.68
Production (000 tonnes)	5,087	5,288	4,330	5,920	5,449
Export (000 tonnes)	7.9	148.3	3.5	2.1	3.8
Import ¹ (000 tonnes)	10	59	51	60	69
SOYBEANS					
Harvested Areas (000 ha)	640	859	896	1,254	1,150
Yields (kw/ha)	8.38	8.96	9.7	9.78	10.47
Production (000 tonnes)	536	769	870	1,227	1,204
Import ² (000 tonnes)	222	401	330	400	450 ³
CASSAVA					
Harvested Areas (000 ha)	8,221	1,350	1,292	1,170	1,186
Yields (kw/ha)	99	105	109	144	121
Production (000 tonnes)	12,103	14,167	14,037	13,312	14,383
Export (000 tonnes)	342,3	385,3	543,4	424,6	810
EEC Quota	750	750	825	825	825
SUGAR					
Production (000 tonnes)		1,810	1,899	1,894	1,994
Import (000 tonnes)		-	-	162	175

¹See *Business News*, March 10 1988 & June 3 1986²From the *World Bank*³Estimated

Source: Supplement to President's Speech before Parliament, March 1 1988.

Appendix 4

THE IRRIGATION PROGRAMME

	1983/84	1984/85	1985/86	1986/87
Dev. Spending (bill Rp)	587.4	658.3	529.6	394.2
External Assistance	203.3	285.9	209.1	227.6
Rupiah Resource	384.1	372.4	383.5	164.6
(Operational & Maintenance Cost)	(32.9)	(46.7)	(46.4)	(40.0)
Physical Progress (000 ha)	428.1	449.2	309.8	107.3
Irrigation Systems	34.6	60.2	12.4	24.7
Groundwater	43.7	49.1	41.4	43.7
Rehabilitation	146.1	208.9	174.7	-
Tertiary	157.3	83.0	26.9	34.1
Swamps	46.4	48.0	54.4	4.8

Source: *The World Bank*

Appendix 5

INDONESIA'S AVERAGE TARIFF RATES IN 1980

Commodity	Tariff (%)
Food and Live Animal	44.0
Beverage and Tobacco	49.2
Inedible Raw Material	18.1
Mineral Fuel	6.3
Vegetable Oils	28.1
Chemicals	18.9
Basic Manufactures	36.8
Transport and Telecommunication Equipment	26.7
Miscellaneous Manufactures	49.9

Source: *The World Bank*

Appendix 6

PRODUCTS AFFECTED BY NON-TARIFF BARRIER IN INDONESIA 1980

	Restrictive Licencing	Quota	Import Ban	State Trading
Food, Beverage and Tobacco	1	0	213	23
Inedible Materials	31	0	44	3
Fuel, Vegetable and Animal Fats	1	0	2	1
Chemicals	53	4	0	0
Basic Manufactures	241	36	3	0
Machinery, Transport and Telecommunication Equipment	117	5	0	0
Miscellaneous Manufactures	10	0	11	0

Source: *The World Bank*

Appendix 7

CHANGING IN IMPORT LICENCING BY ACTIVITY

Activity	Number of CCCN items under licence before Oct. 25	No. of CCCN items covered by Oct. 25 and Jan. 15 decrees	(3)/(2) per cent
(1)	(2)	(3)	(4)
Manufacturing	1,360	943	69.34
Agriculture	122	-	0
Minerals	2	2	100.00
Total	1,484	945	63.68

Source: *The World Bank*

Appendix 8

ESTIMATION OF RICE MARKET IN THE NEAR FUTURE

	1987	1988	1989	1990
Population (000)	171,614	175,217	178,895	182,650
DEMAND				
Percapita Cons. (kg/year)	140.00	142.80	145.66	148.57
Total Cons. (000 tonnes)	24,026	25,021	26,057	27,136
National Stock	2,500	2,500	2,500	2,500
Total Demand (000 tonnes)	26,526	27,521	28,557	29,636
SUPPLY				
Harvested Areas (000 ha)	9,865	9,766	9,669	9,575
Yields (ton/ha) inc. by 3%/year	2.76	2.84	2.93	3.02
Total Supply	27,227	27,494	27,764 *	28,036 *
Yields (ton/ha) inc. by 4%/year	2.76	2.87	2.99	3.10
Total Supply	27,227	28,033	28,863	29,717

Note:

* Less than demand

- Per capita consumption assumed to increase by 2 per cent annually

- Harvested areas assumed to decrease by 1% annually

Appendix 9

THE DEMAND OF SUGAR IN THE NEAR FUTURE

	1987	1988	1989	1990
Population (000)	171,614	175,217	178,895	182,650
Percapita Cons. (kg/year)	11.93	12.20	12.49	12.77
Total Cons. (000 tonnes)	2,047.36	2,138.42	2,233.52	2,332.85
National Stock	260	260	260	260
Total Demand	2,307.36	2,398.42	2,493.52	2,592.85

Employment in Indonesia in Pelita V

Aries ANANTA

INTRODUCTION

High population growth rate is often cited as the cause of low economic growth. It is purely based on a mathematical formula, in which growth in income per capita is simply equal to the rate of income growth minus the rate of population growth. However, the relationship between population changes and economic growth is not as simple as this mathematical formula suggests. We cannot predict changes in income per capita by predicting changes in population growth rate alone. The process of economic growth and its speed are not independent of the process of population growth. In fact there are three population changes that affect economic growth, namely changes in the number of population, in its growth rate and in the composition of the population.

This paper does not attempt to examine the complex relationship between demographic and economic variables. Rather, it only discusses employment as

This paper is a modification of my paper, which is a section in a larger paper submitted for a presentation on "Human Resources Development" in Manila, August 1988. The draft received significant comments from my colleagues in the Demographic Institute, Faculty of Economics, University of Indonesia. Among them I should mention: Dr. M. Djuhari Wirakartakusumah, Dr. Secha Alatas, Dr. Siti Oemijati Djajanegara, Dr. Sulistinah I. Achmad, and Mrs. Sutarsih Muliakusumah. I also appreciate the assistance in computing provided by Ms. Daksini, Mr. Purwanto, Mr. Rudi Bambang Trisilo, and Mr. Zainal Abidin. I am solely responsible, however, of the remaining errors. Most of the data utilised in this paper is taken or calculated from the 1971 Indonesian Population Census, the 1980 Indonesian Population Census, and the 1985 Indonesian Intercensal Population Survey. The three data sets are collected by the Central Bureau of Statistics.

a part of population issues, with a focus on labour force and employment situation in *Pelita V* (Five Year Development Plan), which starts in April 1989 and ends in March 1994. Considering that in Indonesia demographic data are usually collected in five year intervals, and demographic and employment variables generally do not undergo much change in short periods, the discussion will even be confined to the situation in 1990. This paper is, indeed, an attempt to show that data on employment does not and will not undergo much variation even if national income fluctuates and that, instead, it is the earning and the hours worked that change as national income changes. Hence, the discussion on employment condition in 1990 may approximately represent the situation during *Pelita V*. Needless to say, this discussion requires a thorough understanding of past and current situations. This paper, therefore, gives more elaboration on past and current situations of labour force and employment than those of the future.

A misunderstanding of the definition of "employment" and improper translation of "employment" into "*kesempatan kerja*" in the Indonesian language constitutes a serious problem in discussions on Indonesian employment issues and policies. The next section briefly elaborates these mistakes and this will serve as background to the following section, in which I critically discuss Indonesia's employment policy in *Pelita IV* and suggest some policy changes for *Pelita V*. Another section will describe past levels and trends of labour force and employment, followed by a section in which labour force and employment compositions by age, education, and time allocation will be presented. Then a section will show the inadequacy of "employment elasticity method" for analysing future employment, and suggest a modification on the method.

DEFINITION OF EMPLOYMENT

Labour force is officially defined as consisting of both employed and (openly) unemployed persons 10 years old and over. A person is defined as working if he or she works at least one hour in the week preceding the time of population survey. The person may also go to school, do household work but is still defined as working if the person works at least an hour in the preceding week. A person is defined as (openly) unemployed if he or she is not working as defined above but is looking for a job. In other words, to be unemployed a person must be a full-time job-seeker. If a person is looking for a job but is also working at the same time, then he or she is defined as employed whatever work he or she may be doing.

Employment is thus the number of persons working as officially defined above. With this definition of employment we can even analyse the work of, for example, people who are doing whatever job is available, even if simply for the sake of survival. The problem is that users of employment statistics may not be aware of this definition. The data on employment and unemployment cited in the mass media and government statements are frequently based on this definition. In literature written in Indonesian, "employment" is often translated into *kesempatan kerja*, which literally means "job opportunity."

The Central Bureau of Statistics collects data on hours and days worked. This information enables researchers and other data users to examine whether a worker has fully utilised his or her time, though there is another problem, namely that of how full utilisation of time is to be defined. The now common, but not necessarily the appropriate, definition of full utilisation of labour is working 35 hours a week in agriculture and 10 hours a week in other sectors. Working less than 35 or 40 hours a week is defined as under-employed.

EMPLOYMENT POLICIES

The reduction of both the number of openly unemployed labour force and unemployment rate is often made the target of government economic and manpower planning. It was frequently predicted that during Pelita IV (1984-1988) the labour force will have an increase of 9.3 millions. Thus, according to policy makers, the Indonesian economy during Pelita IV should have grown at a rate of at least five per cent annually. With this rate of growth, the additional 9.3 million labour force would have been absorbed by the economy. It has further been said that absorbing the 9.3 million persons was only sufficient to maintain a *status quo* in employment. At the beginning of Pelita IV, Indonesia had 1.3 million openly unemployed persons. Thus, the policy goes, if the country only absorbed 9.3 millions labour force during Pelita IV, at the end of Pelita IV the employment situation would be no better nor worse than at the beginning of Pelita IV.

In a country like Indonesia open unemployment as is officially defined does not constitute the core employment problem. Most of Indonesia's labour force is too poor to afford being openly unemployed. They need something to eat. There is no social security system to ensure unemployment compensation. Only those who have relatively better off relatives or friends are able to prolong their search for proper jobs. The majority has to accept whatever job is available even if the remuneration is very low and the hours worked very long.

Of course, they still seek for jobs while working. Full time search for job, which is the criterion for persons defined as being (openly) unemployed, is a luxury that very few people can afford to engage in. In other words, most of the labour force will be absorbed, irrespective of employment and economic policies. When the economic performance is worsening, a larger percentage of the labour force will even have to work harder and be absorbed by the economy as more people cannot afford to be openly unemployed. Hence, the target of absorbing the additional 9.3 million labour force during Pelita IV has been relatively easy to attain. No serious effort has been needed to absorb most of the labour force. Open unemployment rate has remained small. It has fluctuated around two and three per cent. However, the question remains open as to the quality of employment. The minority of the labour force who can engage in full time search for job is in a better financial position than those who have to work for long hours but with low earning for the sake of survival.

Therefore, economic policy in general and employment policy in particular, should pay much more attention to those who have to work very hard for survival than to the minority of people who can afford to be fully unemployed. Economic and employment plannings should not be primarily aimed at reducing the number and the rate of open unemployment. The absorption of the labour force per se should not be made the main objective, since, in Indonesia, reducing the poverty of the employed, or improving their earning, constitutes a more serious problem.

Indonesia's labour force is projected to reach the 72.4 million in September 1990 (Ananta, Trisilo, and Iskandar, 1988). During Pelita V there will be approximately 9.5 million additional labour force, or an increase of around 1.9 millions annually. Most of these additional labour force will be absorbed by the economy, whatever economic and employment policies are implemented. Only a small fraction will remain openly unemployed.

At the beginning of Pelita V (April 1989) Indonesia will have roughly 1.5 million unemployed labour force and approximately 1.7 millions by the end of Pelita V (March 1994). The rising number of unemployed persons in Pelita V is simply a reflection of the rising number of labour force, which in turn is a reflection of past population growth. Since this part of the labour force is supposed to have a relatively good financial position, its projected increase during Pelita V will not be a serious employment problem, though one has to note here that the assumption on the coincidence between good financial position and open unemployment may have to be loosened over time. Nevertheless, government efforts will be much better spent on raising the level

of earning of the employed persons rather than on attacking open unemployment.

LEVELS AND TRENDS

The Indonesian population has been rising rapidly over the last two decades, but the rate appears most recently to have declined. It increased from 2.10 per cent in 1961-1971 to 2.32 per cent in 1971-1980, and declined to 2.15 per cent in 1980-1985. The growth rate of the working age population, however, continues to be higher than that of the population. It is almost constant in the neighbourhood of 2.93 per cent in 1971-1980 and 2.86 per cent in 1980-1985, but is projected to decline to 2.64 per cent in the 1985-1990 period.

In absolute terms the Indonesian labour force increased from 52.4 millions in 1980 to 63.8 millions in 1985, or by 2.3 millions annually. This increase is higher than the yearly addition of only 1.4 millions in 1971-1980. The annual rate of growth of the labour force is also rising from 2.92 per cent in 1971-1980 to 3.94 per cent in 1980-1985. However, it is projected to decline to 2.53 per cent in 1985-1990. The greatest part of this declining growth rate of the labour force is mostly due to the decline in the growth of the working age population, but partly also to a slight decline in the projected participation rate of the working age population.

Participation rate rose from 49.86 per cent in 1971 to 50.23 per cent in 1980 and 53.02 per cent in 1985, thanks to an increased participation rate of the population in the group of 20-64, whereas the participation rates for the youth (10-14) were declining in both the 1970s and the first half of the 1980s. This declining participation of the young population can be seen as a positive trend as it reflects a temporary relief in terms of new entrance into the labour force. The greatest part of this decline in participation rate is due to enrollment in education. More people may have had the means to postpone entering the labour market.

In the 1971-1980 period the participation even declined for the age group of 65 and over. The decline turned out, however, to be short-lived. It is interesting to pursue the reasons behind the increased participation rate for the old in the 1980-1985 period, after the decline in 1971-1980. Did the old have to go to the labour market in the 1980-1985 period as a consequence of the slowing economic growth?

The growth rate of urban labour force was much higher than the national average, namely 5.47 per cent in the 1971-1980 period and 7.09 per cent in 1980-1985. This was largely due to the fact that urban population in the working age grew faster, namely by 5.55 per cent in the 1971-1980 period and 6.00 per cent in 1980-1985, as a result of migration from rural to urban areas.

It is also interesting to note the dramatic increase in the growth rate of the female labour force, from 2.89 per cent in the 1971-1980 period to 5.65 per cent in 1980-1985, whereas the male counterpart rose only from 2.94 per cent to only 3.03 per cent. On the other hand, female participation rate remained approximately constant for a decade, namely 32.06 per cent in 1971 and 32.65 per cent in 1980. Thereafter, the rate rose rapidly to 37.59 per cent in 1985. The relatively high growth rate of the female population in the working age is the most important explanation for the high growth rate of female labour force. It increased from 2.84 per cent in the 1971-1980 period to 2.83 per cent in 1980-1985, and is projected to slow down to 2.58 per cent in the 1985-1990 period.

It should be noted at this juncture that the rising participation rate of the female population does not necessarily mean a positive development for the women. Further study should be carried out to determine whether their massive entrance to the labour market was caused by the need to compensate for a decline in their family income, or because more choices were open to them. If the latter is the truth, we may infer that the female population was improving their social status relative to the male population.

Employment grew at 2.98 per cent annually in the 1971-1980 period and 3.84 per cent in 1980-1985, only slightly below the growth of the labour force in those periods. It is projected to grow at 2.51 per cent annually or by a total of 8.4 millions during the 1985-1990 period.

The projected decline in employment growth has more to do with the projected decline in labour force growth than with economic prospects or changes in economic policies in general and employment policies in particular.

These figures do not provide a sound basis for saying anything on the success or failure of the government programme on job creation. The rough balance between the growth of the labour force and that of employment seems to indicate simply that the level of income in Indonesia is still too low to allow a high level of open unemployment. Most of the labour force is absorbed by the economy regardless the policies the government adopts. In other words,

employment growth is more a function of the growth of labour force than of fluctuation in economic performance or any government programme. A higher growth rate of employment, for example, does not necessarily indicate a better employment performance. Earning of the worker is more relevant as a measurement of employment performance. Without an increase in earning it is inappropriate to say that employment performance has improved.

Awareness of the absence of relationship between employment, as officially defined, and output would prevent one from drawing conclusions from employment statistics. It would prevent analysts from making such statements as the following: "This year economic growth is predicted to be only four per cent, but employment even rises almost as fast as the labour force does."¹

Closing this section one needs to summarise that the number of unemployed persons rose by 9.1 per cent annually in the first half of the 1980s, or 100 thousand people every year. It is projected to rise by 46 thousand people yearly to become 1.60 millions in 1990. The unemployment rate was 2.22 per cent in 1971, 1.66 per cent in 1980, and 2.14 per cent in 1985. It is likely to remain small at least in the Pelita V. However, this low rate of unemployment has nothing to do with any government policy.

COMPOSITION

Age Composition

The highest percentage of labour force is to be found in the biologically most healthy age group of 25-29. This pattern applies to both urban and rural areas. As to the 1985 urban female, the highest percentage is found in the younger age group of 20-24. Urban female reaches the highest percentage sooner than urban male and some rural female (who are mostly employed at the age of 20-24 and 25-29). But urban female seem likely to withdraw from the labour force once they get married and have children.

In 1980 rural female reaches the highest percentage at a younger age: 15-24. In 1971, both rural female and the totality of the female population have two peaks, at the age of 15-19 and 25-29. The timing of reaching the highest percentage shown by the three data sets may reflect the trend of rising female age at first marriage.

¹*Suara Pembaruan*, 30 December 1987.

The age composition of the labour force is in favour of the young group, but that of unemployment also seems to be concentrated to the young. Most of the unemployed were young: in 1985 around 50 per cent of the unemployed were in the age group of 20-24. This pattern was found both in female and male groups, urban or rural. It indicates that the concentration of unemployment in the young population group was only partly due to the age composition of the labour force, and we may have to find the other part of the explanation in the socio-economic characteristics of the young population group. One possible explanation is that the young, especially those at the age of 20-24, are generally more selective in their search for a job.

Educational Composition

The educational level of the labour force has been improving. In 1971, 42.67 per cent of the labour force had not attended school at all; 28.53 per cent had not finished elementary school; and 21.83 per cent had finished elementary school. The percentage of the uneducated labour force dropped to 29.48 per cent in 1980 and 21.31 per cent in 1985. Those who had not finished elementary school first rose from 28.53 per cent in 1971 to 37.57 per cent in 1980, then dropped to 33.92 per cent in 1985. The percentage of the labour force who had completed elementary or higher education continued to rise.

The trends are expected to continue, and the fraction of population with educational level lower than elementary school will become increasingly smaller both in relative and absolute terms. Indeed, the number of labour force with no schooling at all declined in absolute terms from 17.6 millions in 1971 to 15.5 millions in 1980 and 13.6 millions in 1985.

As was the case with labour force, unemployment remained dominated by those who had low educational level, but the educational attainment seemed to have improved. In 1985, only 34.08 per cent of the unemployed enjoyed primary schooling or lower education, which was in contrast with 75.89 per cent in 1980. But, these figures should be used with caution as the increase appears to be too fast, though there certainly was an improvement during the period. In 1980 there were only 209,036 educated (junior high school and above) unemployed persons constituting only 0.4 per cent of the total labour force. The number increased to 902,092 in 1985, or 1.4 per cent of the total labour force.

Unemployment Rate by Educational Level

One characteristic of Indonesia's recent unemployment record is that the rate of unemployment among senior high school labour force is very high. The rate was 14.99 per cent for those having completed general senior high school, and 8.68 per cent for those having completed vocational senior high school, in 1985 while the unemployment rate was very low (0.32 per cent) among those without schooling.

This relatively high rate of unemployment among the labour force with higher educational attainment is often cited as an indication of the failure of the educational system to respond to the needs of economic development. However, this statement is doubtful since one cannot infer anything in the education system solely from the number of unemployment with a relatively high educational attainment alone.

The part of the labour force with higher educational attainment belonged most likely to the more "fortunate" members of the Indonesian population in terms of the ability to survive in a jobless period. The fact that they were unemployed meant basically that they could afford being unemployed. This was in contrast to the majority of people who had to accept any kind of employment only in order to survive. In other words, unemployed persons with higher educational attainment were relatively luckier than workers with low educational attainment. Furthermore, they accounted for only 1.4 per cent of the labour force. Thus, high unemployment rate among the labour force with higher educational attainment is not as serious an "economic" problem for the time being. While the number and the rate of unemployment among the educated labour force are likely to continue to rise in the Pelita V, it remains to be seen to what extent the associated problems deteriorate.

EMPLOYMENT GROWTH AND ECONOMIC GROWTH

Employment Elasticity

Employment growth is often thought to be related to value added growth as the demand for labour is a derived demand which depends on the demand for goods and services. Unfortunately, it is not easy to measure demand for labour and that for goods and services.

In the fragmented literatures on Indonesian employment, changes in the demand for goods and services have been estimated on the basis of changes in gross domestic product, and changes in the demand for labour on the basis of changes in the number of employed persons (employment). Employment elasticity has been defined as a ratio of percentage changes in the number of employed persons to those in gross domestic product. Employment elasticity is used as an indicator of the demand for labourers or the capacity of the economy to absorb workers. Worse, the employment elasticity is used as a summary index of the employment problem.

Employment elasticity of the GDP is a very poor indicator for judging employment performance in such a country as Indonesia, where there is no unemployment compensation. Economic growth may worsen and lay-offs may increase in the modern sectors, yet the number of open unemployment may continue to be low as people attempt to find other jobs, most probably in the informal sectors. This movement into the informal sectors is ignored in the estimation of the employment elasticity of the GDP.

In 1980-1985, a period with slow economic growth, total employment rose by 3.84 per cent annually while the GDP increased only by 2.0 per cent annually. This resulted in a very high employment elasticity of 1.9 during the period, which indicates a high demand for labour in the 1980-1985 period. This conclusion is contradictory to the fact that in the 1980-1985 period many people were complaining about the difficulty to obtain proper jobs.

As mentioned in section 4, employment growth is projected to be no higher than 2.5 per cent annually during Pelita V. Therefore, with a targeted growth of 5.0 per cent per annum an employment elasticity of the GDP in the order of 0.5 would be high enough to expand employment by 2.5 per cent per annum. However, this targeted employment elasticity is insignificant for policy making.

Employment growth is not affected by that of income. The high growth rate of employment (3.84 per cent), which was close to that of the labour force (3.94 per cent) in the 1980-1985 period, should never be interpreted as the success of government programmes in creating employment. On the contrary, the weaker the economic performance, the closer will the rate of employment growth be to the growth rate of labour force.²

²Only when the economy is so bad that almost nobody can afford being unemployed will the number of unemployed persons decline.

It is unlikely that changes in the present economic conditions will significantly affect the number of employed persons. Economic changes, undoubtedly, affect the demand for labour, but the demand for labour should not be mistaken for the number of employed persons. Analysis on the demand for labour should consider the number of working hours of all jobs. The analysis should also take into account the wage/earning based on the hours worked. Unfortunately, there is no reliable data on the hours worked in *all* jobs. Worse, relevant data on wages/earnings is not available. Therefore, there is no way in which one can estimate the appropriate demand for labour in Indonesia.

Nevertheless, the impossibility to estimate the appropriate demand for labour is not an excuse to use such a misleading method as (total) employment elasticity to highlight an employment situation. Employment analysis based on employment elasticity should be used with great caution. Any policy derived from such an analysis is based on unreliable grounds.³ Employment elasticity may be of some relevance only to the formal employment sector, and changes in economic condition may affect employment. Furthermore, a weakening growth performance in the formal sector may lead to higher unemployment. As a general rule, however, those who cannot find a job in the formal sector will resort to the informal sector.

Formal Employment Elasticity

The elasticity of formal employment is defined as percentage changes in the formal sector employment divided by percentage changes in value added. The formal sector employment comprises workers who work as regular employees and employers with regular employees. The remaining workers belong to the informal sector.⁴

In 1985, 1.16 per cent of the workers are employers and 30.08 per cent are employees. The percentage of workers in the formal sector (31.24 per cent) has hardly increased compared to that of 1980. It is worth noting that in the 1980-1985 period, the annual growth rate of employment in the formal sector (4.56 per cent) was higher than that of the informal sector (3.52 per cent) in spite of the many lay-offs in big companies so frequently discussed in the mass media. If this trend continues and the economic growth improves the percentage of workers working in the informal sectors will decline.

³Underemployment is measured as percentage of sectoral employment with working hours less than 35 hours a week in their main job.

⁴The percentage shows percentage of hours worked in *all* jobs, and not limited to the main job.

The highest rate of employment elasticity (2.52) of the formal sector in the 1980-1985 period was found in wholesale, retail trade, and restaurants, followed by construction (1.68).

Ananta, Trisilo, and Iskandar (1988) present three scenarios for gross domestic product growth and three scenarios for sectoral employment elasticity of the formal sector in the 1985-1990 period.⁵ Based on these scenarios, nine scenarios for formal employment growth in 1985-1990 period are derived.

In the highest scenarios (with a maximum growth rate of sectoral gross domestic product and an elasticity 10 per cent larger than in 1980-1985) 33.8 millions people will work in the formal sector or 47.74 per cent of projected the total employment in 1990.

In the lowest scenario (with minimum growth rate of sectoral gross domestic product and an elasticity of 10 per cent smaller) there will be only 22.4 million workers in the formal sector or 31.7 per cent of the projected total employment in 1990. Therefore, formal sector employment is estimated to range from 22.4 millions to 33.8 millions in 1990, or from 31.7 per cent to 47.7 per cent of the total employment. The worst scenario reveals an almost constant share of formal sector employment in 1990.

SUMMARY

Focus on Income

Employment growth rate has been and will be close to the labour force growth rate. This pattern will be observed at least until Pelita V. The number of unemployed persons will continue to rise during Pelita V, but the rate of unemployment will remain low, between two and three per cent. The employment growth rate which is close to the growth rate of labour force does not necessarily indicate the success of an employment programme.

The Indonesian economy is still too poor to finance open unemployment. Most of the labour force will be employed, regardless the performance of the

⁵The three scenarios for growth in sectoral gross domestic product are as follows: (1) sectoral growth in 1985-1990 period is equal to average growth in respective sectors in the 1980-1985 period; (2) sectoral growth is equal to maximum growth in respective sectors in the 1980-1985 period; (3) sectoral growth is equal to minimum growth in respective sectors in the 1980-1985 period. The three scenarios for formal employment elasticity are as follows: elasticity is equal to elasticity in the 1980-1985 period, 10 per cent larger than the elasticity in 1980-1985 period and 10 per cent smaller than the elasticity in 1980-1985 period.

economy. In other words, government policies should not be focused on the reduction of openly unemployed persons or the rate thereof. Rising unemployment rate is a reflection of the ability of the labour force to finance being unemployed, that is the ability to survive without having a job. Instead, the focus of any employment programme should be centred on the raising of the income of the majority of the population.

Urban and Female Labour Force

Another main characteristic of the Indonesian employment has been the high growth rates of both urban labour force and female labour force. The high growth rate of the urban labour force is mainly due to the high growth rate of the urban working age population, which reflects migration from rural to urban areas and changes in administrative unit from rural status to urban status. This trend will continue in the Pelita V. It suggests that more attention needs to be paid to the urban socio-economic and ecological environments. This urban environment will have an influence that is different from rural environment on workers' productivity. Studies on urban environment and its impact on labour productivity should be given high priority in conducting research on employment.

Unlike the urban labour force, the high growth rate of the female labour force is attributable to both growth of female working age population and rising female labour force participation. The relatively high growth of female working age population is simply a reflection of the past high population growth.

The rising participation rate of the female labour force does not necessarily indicate that female population now has more job opportunities. Further studies should be made to determine whether they enter the labour market because they are economically worse off and, thereby, forced to contribute to the household income, or because more choices are now open to them.

Better Educated Labour Force and Unemployment

The education of the labour force has been improving and will continue to improve. The education pattern of the unemployed labour force is similar to that of the labour force.

The number of low-educated (junior high school and lower) unemployed

persons is very small. Namely 902,092 in 1985 or 1.4 per cent of the total labour force. However, unemployment rate is very high for the labour force with higher educational attainment.

The high unemployment rate among the labour force with higher educational attainment is often cited as an indicator of the failure of the educational system, but this is not necessarily the case, since the high rate simply reflects that they can afford to prolong their search for jobs, owing to their relatively good financial position.

Assuming a continuous progress in development, unemployment rate among the educated labour force is likely to continue to rise. However, this increase does not pose a serious problem.

Manpower Planning

The frequently used manpower planning techniques, which uses the employment elasticity method, should be used with great caution. This method is often used to analyse or predict the employment absorption capacity of the economy. Any policy based on an analysis derived from employment elasticity may result in a misleading conclusion. The employment elasticity method leads analysts to think that the total number of employed persons is affected by the growth rate of the economy. Indeed, the growth rate of employment is influenced by the growth rate of labour force, not that of the economy. This pattern of employment growth will be observed at least Pelita V.

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The Big Powers in Southeast Asia in the 1990's: Their Interests and Roles

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Without ostentatious attempts to define what may constitute a big power with any degree of scientific rigour, this paper will focus its attention on the PRC, the USSR, the USA, and Japan, four principal major powers with long-standing interests and major roles to play in Southeast Asia and barring any sudden and unexpected term of events that may reverse the current trends, the prospect of their current trends to continue in the 1990's or toward the end of the present century. The interests and roles of these big powers are certainly interlinked with one another. On the one hand, for instance, the interests and roles of one big power may increase to the extent that those of another big power have also increased because of the adversarial or competitive nature of the relationship between the two. Yet on the other hand, one big power's interests and roles may increase for precisely the opposite reason so as to fill the vacuum left by the decrease in the interests and roles of another big power without a necessary change in the adversarial or competitive nature of their relationship. Strictly speaking, therefore, the interests and roles of each of the big powers cannot possibly be examined in complete isolation. The treatment of the interests and roles of the four big powers one by one in this paper is mainly for convenience' sake.

From the point of view of the nations in Southeast Asia, the interests and roles of the big powers may serve as a stabilising factor ensuring peace and security in the region. On the other hand, they may also serve as a destabilising factor disturbing the peace and security of the region. Whether the big powers

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act one way or the other would depend by and large on the extent of what is commonly perceived as the mutuality or commonality of interests between the big powers on the one hand and the nations of the region on the other as well as among the big powers themselves. Thus any discussion on the interests and roles of the big powers in Southeast Asia must also take account of the perceptions of the nations in the region, who may perceive the big powers as sources of external threat to their security for having interests in conflict with their own. On the other hand, they may see the big powers as ensuring their security for sharing with them some common potential enemy.

Perception, of course, varies from nation to nation, and for the same nation it often varies also from one period of time to another. Some nations may perceive certain big powers, but not others, as sources of threat to their security. Other nations, however, may have precisely the opposite perception. Thus the same big powers may be perceived differently by different nations of the region at different times.

Moreover, if differently in accordance with their different perceptions, the interests and roles of the big powers as well as the relationship among them, of which their interests and roles, as briefly referred to earlier, are also a function, will both impact on the domestic and foreign policies of the nations in the region in response to them individually as well as collectively. These issues will be examined as the discussion proceeds to treat the interests and roles of the individual big powers. And finally the paper will discuss the appropriate ways in which the nations of Southeast Asia, particularly the ASEAN member states, should co-operate in the face of the interests and roles of the big powers and the relationship among them so as to serve their own national as well as regional interests.

THE PRC

Under the pragmatic, moderate, and reformist leadership of present-day China, represented notably by Deng Xiaoping and his team, and having been generally accepted in the world community since its entry into the United Nations in 1971 and its rapprochement with the United States, China is now widely believed to be a more or less contented power, no longer challenging the legitimacy of the present international order. With the launching of the four-modernisation programme, the PRC is believed to be more inwardly oriented and, hopefully, less prone to aggressive international behaviour. Assuming

that Deng Xiaoping has succeeded in establishing his followers in the leadership position in the party as well as in government, the trend is likely to continue over the next decade or beyond.

It is no doubt for the success of the modernisation programme that the PRC has been opening itself to the outside world, more particularly to the United States and the West including Japan in an attempt to obtain the badly needed capital and technology. In fact, at least for a time, if not an alliance, the PRC was seen entering into a loose alignment with the United States and Japan against the Soviet Union. The seeming Soviet encirclement of China then completed with the Soviet presence in the North along the Sino-Soviet border, in the South the increasing Soviet presence in Vietnam, in the West the Soviet occupation of Afghanistan, and in the East the Soviet naval buildup in the Pacific, was certainly a major factor also that had encouraged the Chinese to turn increasingly to the West, the United States in particular.

In other words, the PRC's growing relationship with the United States and Japan was in part a function of the then Sino-Soviet dispute, just as the United States' rapprochement with the PRC has been a function of Soviet-US relations. It may even be argued that the PRC's four-modernisation programme, which, as mentioned earlier, was a major consideration for its opening to the West, was also a function of its dispute with the Soviet Union to the extent that defence has been one of the fields covered by the modernisation programme.

What had for some time seemed to be an anti-Soviet alliance in the making between the PRC, and the United States plus Japan, however, was shortly dashed at the beginning of this decade when Mao's "Three Worlds Theory" presented by none other than Deng Xiaoping himself in the mid 1970's was shelved and replaced by China's strategy to pursue an "independent" policy, namely, independent of the two superpowers.¹ This independence may have been strengthened by improvement in Sino-Soviet relations toward normalisation and detente and the fact that not all is well in China's relations with the United States, which have not been entirely free from occasional strains.

China's ability to develop a more and more independent policy of the superpowers has enabled it to achieve its objective of "rolling back" the superpowers and to pursue a more balanced and "equidistant" relations with the superpowers thereby improving its position in the strategic "triangle." It is within this framework that it would be in the Chinese interest to pursue a

¹See Peter J. Oplitz, "China in the Asia-Pacific Region," *Aussenpolitik* 1/88, p. 75.

policy in Southeast Asia with the aim of stemming or neutralising the influence of both superpowers in the region and of promoting its own relations with the countries of the region. This may serve to explain the change in China's attitude toward ASEAN from suspicion and vilification in the first few years of its establishment to gradual acceptance, approval and sympathy in the mid 1970's. It even approved ASEAN's proposal for ZOPFAN. Other factors, to be sure, contributed to this changing attitude on the part of the Chinese. These were the American withdrawal from Indochina, the demise of SEATO, and the improvement of the Soviet position in Vietnam.²

China's relations with ASEAN has improved further after the Vietnamese invasion and occupation of Kampuchea in 1978. ASEAN's position has coincided with its own strategy, and particularly with Thailand, the "frontline" state under the new circumstances, it has maintained a close alignment, if not alliance, acting as a guarantor of the latter's security against the Vietnamese threat. Small wonder that from the point of view of ASEAN, particularly Thailand -- and the United States, which has continued to express support for ASEAN's (and China's) stand on the Kampuchean conflict -- China has often been described as playing a positive and constructive role and as a stabilising factor in Southeast Asia.

For some reasons, however, such a proposition may be of doubtful validity. China definitely holds the key, at least one of the keys, to the solution of the Kampuchean conflict. Rightly or wrongly, one of the principal reasons for the Vietnamese action in Kampuchea has always been, in the judgement of Vietnam, the Chinese threat. They have been the main supporter of the Khmer Rouge, the strongest in the anti-Vietnamese resistance forces and the strongest element in the CGDK. On the other hand, opposition to the Khmer Rouge as a political and military force has continued to be Vietnam's bottom line. Now that almost all parties involved or interested in the Kampuchean conflict pending and in preparation for the so-called Jakarta Informal Meeting (JIM) seem to have indicated greater flexibility -- the readiness of the four Khmer groups to meet, that of Vietnam to attend the meeting, that of ASEAN to support and probably to attend the meeting, if represented by Indonesia as "interlocutor" and probably also Thailand, that of the Soviet Union to use whatever influence to persuade Vietnam to be more flexible toward a political solution, and even a slight improvement in the dialogue between Vietnam and the USA over the issue of MIA's and related humanitarian problems -- China alone, apart from expressing support for the meeting, has not seemed to budge from its original,

²*Ibid.*, p. 81.

hardline position.³ Indeed, China is in a position to play a decisive role in the undertaking. And it would really play a positive, constructive and stabilising role if it should modify its stand on the Khmer Rouge, especially now in the light of its developing detente with the Soviet Union, as a quid pro quo for what the Soviet Union may be willing to do with respect to Vietnam paving the way for a final and lasting solution of the Kampuchean problem. If indeed the Sino-Vietnamese dispute, which forms an important or even essential element of the Kampuchean conflict, has been also a function of Sino-Soviet dispute, then such an understanding between China and the Soviet Union now does seem to make sense in the light of further normalisation and growing detente between the two countries.

Indeed, it seems hard to suggest on what business the Chinese may really have in supporting the Khmer Rouge forces against Vietnam either before or after the Vietnamese invasion. To suggest that the Chinese support for the Khmer Rouge is somehow an altruistic action and motivated by the Chinese adherence to some principle in international relations simply to help a neighbouring country -- if without a common border -- and its people would seem no better and no more cogent than the Vietnamese claim that it has invaded and occupied Kampuchea in order to "liberate" the Kampuchean people from Pol Pot's atrocities. At any rate, however, the Vietnamese, in addition, have acknowledged their more basic reason for their action in Kampuchea, which is, rightly or wrongly, their strategic, national security interest, and which serves to explain their desire for a "special" relationship with Kampuchea.

The Chinese, by contrast, have made no comparable claim in their conflict with the Vietnamese over Kampuchea. It seems inconceivable that even Indochina as a whole under Vietnamese influence, hegemony, domination or whatever, should pose a threat to China unless it has its own ambition or design for the Indochinese peninsula if not the whole region of Southeast Asia.

If that should be the case, then it is not difficult to see that China may regard Vietnam with its aspiration as an obstacle to the realisation of its own ambition and design in the region. This would be a fundamental conflict of interest between Vietnam and China, which constitutes an essential element of the Kampuchean problem as referred to earlier.

³A Chinese high-ranking official has stated in a recent conference on the great powers in Southeast Asia that China would accept a future Kampuchea as being "different from ten years before," reflecting, hopefully, a slight change toward accommodation.

Moreover, the Chinese accusation that Vietnam is no more than a Soviet proxy symbolising the Soviet threat, and thus for the Chinese the Kampuchean conflict is a function of the Sino-Soviet dispute, seems to be a moot point. For the Vietnamese claim that it has invited the Soviet Union and has relied on it as a strong partner or ally to counter the Chinese threat does seem to have some degree of cogency. Indeed, the tricky question is which has come first, the Chinese threat to Vietnam, or Vietnam's alliance with the Soviet Union, which the Chinese understandably perceives as posing a threat to their security? The Chinese view may be a question of putting the cart before the ox. Still, this should not necessarily be an issue if both the Soviet Union and China are seriously interested in normalising their relations and in helping to find a peaceful political solution of the Kampuchean conflict. And the "third condition" laid down by the Chinese for normalising relations with the Soviet Union and for a Sino-Soviet summit meeting may be met by the Soviet Union in return for a change in the Chinese attitude regarding the Khmer Rouge as mentioned before.

Finally, it must be noted that China's improved relations with ASEAN has not applied equally to the individual member states of the association, particularly Indonesia -- with which diplomatic relations have remained "suspended" since 1967 -- and Singapore, apparently in mere deference to Indonesia, who still entertains doubts about the Chinese link with communists in Southeast Asia and thus their future intentions in the region. It may be true that China no longer provides material assistance for the communists in Southeast Asia except, of course, the Khmer Rouge forces in Kampuchea and in their sanctuary in Thailand in their continued fight against the Vietnamese. The Chinese have also repeatedly assured the nations of Southeast Asia that they only maintain political and moral relations with and provide moral support for the communists in the region, whatever that means.

Such an assurance, of course, makes sense under the circumstances. Physically and organisationally the communists in the non-communist countries of Southeast Asia, particularly the ASEAN member states, have been crippled. The communist parties in these countries, whatever their orientation, to Moscow or Beijing, are now banned. Moreover, given the interest of the PRC in improving relations with the ASEAN states as discussed above, there is most probably little ground for the communists in the region, except perhaps for their own reasons in the Philippines, to create trouble for the existing regimes that would only damage Chinese foreign policy interests. There is thus little reason also for the PRC to provide more than "moral" support for the communists in the region. And in view of the present priorities in China's

domestic policy of reform and modernisation, China is not likely to be anxious to provide the communists in the region with any assistance other than such a form of support.

Given the possibility of success in the future in its modernisation programme, however, which would inevitably result in its increased economic, technological, and military capabilities, it remains an open question whether China will from then on continue to pursue its "moderate" policy and not revert to a militant and revolutionary stance or emerge as a rising global power with claims for global and regional roles, interests and influence, which are not necessarily positive and constructive. It is to be recalled also that there continues to be a lingering fear and suspicion in Southeast Asia that the PRC may have a claim for a sphere of influence in the region on historical grounds.

Moreover, the Chinese have clearly not abandoned, and most probably never will abandon, its principle of assisting communist movements in Southeast Asia as has been indicated by their constant refusal to make a statement to that effect as demanded by Indonesia in order to normalise relations between the two countries. Indeed, it seems arguable if such a demand is sensible and realistic, and if Indonesia's persistent demand is not only an indication of its reluctance to normalise relations with China at this stage, for whatever reasons.

Nevertheless, Indonesia deserves a credit for making moves that may pave the way for normalisation of relations with China at some future date. One of these is its opening direct trade relations with China. Another is a proposition recently put forward by the Indonesian President in his speech before the People's Consultative Assembly that to normalise relations China should refrain from interfering in the domestic affairs of the nations in Southeast Asia, a principle which the Chinese have certainly pledged to respect for a long time, for instance as one of the Bandung principles which they have often professed to be one of the guiding principles in their relations with other nations.

Indonesia's move, if still a long way to normalisation, may be due to its recognition of the change in Chinese policy under the post-Mao leadership and to its realisation that as a great regional power China cannot be ignored forever, and that like it or not it will have an important role to play in the region. It seems unfortunate that despite what may have looked like a positive sign of movement toward accommodation with China, the Chinese recent action over the Spratleys may have caused a slight setback in that direction.

THE USSR

One of the most significant developments for the region of Southeast Asia relating to the Soviet Union in recent years has been its increasing presence in Vietnam as a result of the Kampuchean conflict as well as the Soviet military, especially naval buildup in the wider region of the Far East. The acquisition of military bases or facilities in Cam Ranh Bay and Da Nang has brought the Soviet Union into greater geographic proximity to Southeast Asia. This would increase the Soviet capabilities to intervene in the region, albeit over a long-term, if the opportunity should arise for such intervention and the need as well as the interests of Soviet foreign policy should warrant such a course of action.

Indeed, the Soviet foothold in Vietnam is the one plus factor in the recent developments of the Asia-Pacific region for the Soviet Union. In fact, the Soviet Union seems to have benefited most from the Kampuchean conflict, perhaps more than Vietnam's gains, especially in strategic and political terms. Its foothold in Vietnam may serve as a possible stepping stone for future initiatives. This is not to suggest that the ASEAN states may become targets of a direct Soviet attack from the bases or facilities in Vietnam. But the Soviet presence in Vietnam may have future political and security implications for other nations in Southeast Asia. Thailand, for example, would certainly tend to be concerned over such possible implications because of the nature of its present relations with Vietnam since the Vietnamese invasion and occupation of Kampuchea, considered to be a buffer between the two countries.

On the other hand, there are reasons for certain other countries, notably Indonesia and Malaysia, to be more concerned about the threat that may be posed by China than the Soviet threat. The Chinese enjoy certain advantages over the Soviet Union in their dealing with the Southeast Asian region so that the Chinese threat seems more real and menacing. China has greater geographic proximity. It may have a claim for influence in the region on historical grounds. There are large "overseas" Chinese communities in the region, part of which may be susceptible to influence and exploitation by the PRC. And the Chinese have closer racial and cultural affinity with the peoples of the region.

Moreover, on its own the region of Southeast Asia is never of vital interest to the Soviet Union. It is therefore unlikely to be on the top of Soviet strategic and foreign policy priority in comparison with such other regions of the world as Europe, the Middle East, South and Northeast Asia, which, bordering on the Soviet Union itself, are more directly related to Soviet strategic and securi-

ty interest. If Southeast Asia should assume increasing importance to the Soviet Union, and hence the significance of its presence in Vietnam, it is probably more as a part of Soviet attempts to counter the continued overwhelming presence of the United States in the Asia-Pacific region in military, political, and economic terms over the past four decades. And as a rising global and superpower, the Soviet Union has certainly an interest not only in flying the flag all over the globe but in being taken into account as a factor in the solution of international problems.

On that basis, in fact, the expectations on the part of the ASEAN states that because of Vietnam's heavy dependence on Soviet aid and support the Soviet Union alone would be in a position to bring pressure to bear on Vietnam to withdraw from Kampuchea would at first glance appear to make sense. But such expectations seem to ignore the possibility that even if able to do so the Soviet Union may not be willing to pay the price. Moreover, the Kampuchean conflict has developed to such an extent that it has involved a number of external powers, not just the Soviet Union. Above all, no one should overlook the important role to be played by China as discussed earlier.

Nevertheless, it is possible, as has been argued elsewhere, that with recent changes in Soviet naval deployments suggesting a retrenchment from the era of forward deployments, the Soviet Union may well be less inclined to pay too heavy political and economic price for the bases provided by Vietnam,⁴ so that the recent apparent change in the Vietnamese attitude toward greater flexibility may have in part due to some pressure by the Soviet Union, which has indeed indicated its interest in playing a more active and positive role in the search for a solution of the Kampuchean impasse and in using its influence on Vietnam to that end. Moreover, by doing its part in that undertaking, the Soviet Union will have the occasion to demonstrate the sincerity of its desire to improve relations with the countries of the Asia-Pacific region as expressed in Gorbachev's speech at Vladivostok in July 1986. To persist in its support for Vietnam in Kampuchea without the slightest flexibility would only further alienate the ASEAN states. It would run counter to its desire to improve state-to-state relations with them and to prevent them from being transformed into an anti-Soviet bloc with security ties to the USA. Thus the Soviet Union will have to strike a balance between its alliance with Vietnam and its normal relations with the ASEAN states.

⁴Gerald Segal, "The USSR and Asia in 1987," *Asian Survey*, Vol. XXVIII, No. 1 (January 1988), p. 4.

Indeed, a number of current developments may create conditions that would be favourable for the Soviet Union to play a positive role in Southeast Asia. The first is the era of reform in the Soviet Union under the leadership of Gorbachev that is likely to have a positive impact on Soviet foreign policy behaviour. For the success of its domestic reforms, the Soviet Union would need a favourable international climate. It would need to promote good relations and close co-operation with other countries. This would certainly include the ASEAN states. The second, also related to the era of *glasnost* and *perestroika*, is the development of a new detente with the USA resulting in the reduction of East-West tension.⁵ And the third is the development of Sino-Soviet detente.⁶ And as far as Southeast Asia is concerned, and indeed for the world at large, these developments seem to augur well for the Soviet role in the 1990's.

THE USA

The American presence has continued to be a fact of life in the Asia-Pacific, including Southeast Asia even after American withdrawal from Vietnam and despite the Guam doctrine, which is now the accepted wisdom governing American policy underlying its relations with the countries of the region. The United States has maintained its security commitments to Japan, South Korea, Thailand, the Philippines, and Australia. It has continued to enjoy a chain of military bases around the area, its 7th fleet patrolling the waters of Western Pacific and in part even the Indian Ocean.

In addition, in contrast to the Soviet Union, the general developments in the Asia-Pacific environment, including Southeast Asia, have continued to favour the United States for the past two decades. With the exception of the Indochinese countries, the nations of the region are either pro-West or oriented to the West or otherwise favourably disposed toward the West. Apart from security treaties with the United States on the part of some of countries, notably Thailand and the Philippines, the non-communist nations have maintained intensive political, economic and trade relations with the United States resulting in increasing interdependence between them. Thus the generally overwhelming presence of the United States in the Asia-Pacific region and in

⁵See my comment in "Asia Tenggara dan Hubungan Timur-Barat," *Analisa*, Vol. XVII, No. 3 (March 1988).

⁶I discuss this question in "Sino-Soviet Detente and Southeast Asia" in the forthcoming issue of *Pacific Review* No. 3 (London).

Southeast Asia is something the nations in the area have tended to take for granted.

Above all, the principle of non-alignment on the part of some countries notwithstanding, the non-communist countries are all aware and some even feel assured of the lingering American military presence behind their backs. To be sure, some countries, least of all Indonesia, would not like to be openly identified with it nor always look on it with total and open approval, let alone tolerate its existence on their soil. But some of them tend to see the American military presence in effect as their ultimate insurance. Therefore, most nations in Southeast Asia, particularly the ASEAN states, will continue to welcome the US presence, including military presence, in the years ahead. It is the American military power that will continue to act as a formidable restraint on Japan, and this is reassuring to Japan's neighbours who still harbour some lingering doubts about its future intentions. It is also American power that at present is able to exert, hopefully, a moderating influence on the PRC, with whom US relations should not be developed at the expences of the interests of the nations in Southeast Asia. And clearly it is American military power alone that can act as a counterbalance against the Soviet military presence. This does not imply, especially as far as the uncommitted nations are concerned, that the United States is here to defend them against the Soviet threat or any other potential enemy. It does mean, rather, that the American military presence is there to preserve a general balance of power in the region so as to prevent any one great power from becoming predominant in the region.

It must be noted, however, that the US military presence is not necessarily the same as the presence of US military bases. By the same token, the possible removal of the US military bases in the Philippines, if that should be the final outcome of the present review and negotiations between the Philippines and the USA to determine the future of those bases after 1991, would not necessarily mean US withdrawal from the region of Southeast Asia, although the presence of the bases may indeed facilitate US military presence. It seems hard to believe that as a global power, especially in the face of increasing interests and roles of the Soviet Union and the PRC, the USA will really consider withdrawing completely from the region,⁷ although the increasing interests and roles of other big powers may result in the reduction of US heretofore preponderant role.

⁷See my commentary, "ASEAN and the US Bases," *ibid.*, Vol. XVI, No. 2 (April 1988), pp. 161-5.

Finally, the possibility of the United States playing a role in the search for a solution of the Kampuchean conflict may be considered.⁸ For the United States simply to continue to support the ASEAN position on the problem may create the impression not only that it is not really interested in the regional problems of Southeast Asia, in spite of the rhetorics. The United States is in a position, for instance, to consider using its influence not only on Thailand but also on the PRC with a view to developing greater flexibility on the part of both countries in their policy toward Vietnam. And above all, the United States may consider seriously at least over the long run to normalise relations with Vietnam and even ultimately to provide Vietnam with an alternative source of aid for the reconstruction of the country. To continue its present low-cost policy of doing practically nothing on the Kampuchean conflict would be counterproductive in the sense of helping to perpetuate and to strengthen Vietnam's dependence on and alliance with the Soviet Union with possible political and security implication for Southeast Asia as referred to before.

JAPAN

Unlike the other three big powers, Japan's interests and roles in Southeast Asia have been primarily economic. Surely, Japan has also great interest in the political stability, peace and security in the region, if only because these factors would serve to ensure its interest in trade and other forms of economic relations and co-operation with the countries of the region.

The attitude of the Southeast Asian nations toward Japan, however, has been marked largely by ambivalence. On the one hand, there have often been suggestions that Japan should also play a role in the political and even security fields commensurate with its enormous economic power and potentials, which often classify Japan as an economic superpower. Yet on the other hand, any indication of Japan's interest in playing a more significant role in the political, let alone security field, tends to arouse suspicion and even fear on the part of its neighbours, including the countries in Southeast Asia, based on their experiences of Japanese occupation during World War II. They fear the possible resurgence of Japanese militarism.

In point of fact, such fear and suspicion may turn out to be unfounded. It may be true that in Japan, just as in many other societies, there exists a mili-

⁸For a discussion on US role in the Kampuchean conflict see my article, "ASEAN Regionalism and the Role of the USA," *Indonesian Quarterly*, Vol. XII, No. 1 (January 1984), pp. 62-73.

tant, chauvinistic group of fanatics imbued with extreme military spirit and with a belief in violence for the defence of certain ideals. But for one thing, the experience of the Japanese in the suffering caused by the war, particularly as a result of the atomic bombs, would certainly make the majority of the Japanese people so averse to war. For another, now Japan can have access to and does enjoy many things that it benefits from peaceful, friendly relations and co-operation with many nations, including the nations of Southeast Asia, but which it had to try to obtain in the past by means of war. Moreover, no nation deserves to be condemned forever for what its previous generation of people did.

Such fear and suspicion, however, may nevertheless be real. At least there are apparently always some groups of people in Southeast Asia that are quick to raise such an issue and to exploit such fear and suspicion, however unfounded they may be, to serve their own political ends whenever an occasion presents itself such as one created by the Japanese plan to increase defence capabilities by increasing the defence budget. This will create tension that is likely to damage Japan's relations with the countries of the region.

In its own interest, Japan should always take such a possibility into account in dealing with the Southeast Asian countries. In order to minimise misunderstanding and to overcome fear and suspicion, it should maintain close communication with the countries of the region so as to keep them well and fully informed of whatever policy Japan may adopt, particularly if it relates to political, security and defence matters.

More importantly, however, there seems to be little need for Japan to make a distinction among its economic, political and security roles. Its economic role, especially in assisting the nations of Southeast Asia in their national development, through various forms of economic aid and co-operation, will have political and security dimensions. For to help the Southeast Asian nations in such a way would also mean to help them create prosperity, thereby assisting them in the development of their national and regional resilience. In that sense Japan will also help create political stability, peace and security, which ultimately would also serve its own interests.

As regards Japan's own security needs, it may be hoped that it will continue to maintain its security and defence ties with the United States. Indeed, such an expectation is a reflection of the ambivalent attitude on the part of some countries in Southeast Asia regarding military alliance and foreign military bases. But be that as it may, it is its reliance on the credibility of US

commitment to its defence and protection that would continue to deny Japan any excuse or pretext to "go it alone" in defence and security matters. This would give the nations of Southeast Asia a peace of mind.

SOUTHEAST ASIA AND THE BIG POWERS: A CONCLUSION

Except as regards relations between Japan and the Soviet Union, relations among the other three big powers are now marked by detente or rapprochement so as to form a triangular relationship. Certain adjustments may continue to be made so as to maintain a kind of dynamic balance in the triangle. This would mean that in playing its role in Southeast Asia, each one of the big powers will take account of the interests and roles of the other two or even three big powers. The possible significance of this phenomenon is that it may no longer serve the interests of the nations of Southeast Asia to ally themselves too closely with or to rely too heavily on any one of the big powers as when they were in conflict with each other. Here lies the relevance and importance of the principle of self-reliance, national and regional resilience and hence regional co-operation as exemplified by ASEAN.

Under the circumstances, the idea of ZOPFAN is also of real relevance. The big power triangle would not mean that the big powers would cancel each other out. It would mean, however, that they will continue to balance one another or even "neutralise" one another. They would manage their triangular or perhaps one day quadrangular relationship in such a way as not to embroil the countries of Southeast Asia in their possible strain, friction and tension, if not conflicts, because of their likely continued competitive nature of relationship despite detente, rapprochement and even co-operation in certain areas of common interest. This seems the time when one may expect the big powers to be less reluctant to accept and approve the idea of the zone of peace, freedom and neutrality (ZOPFAN) for the region of Southeast Asia as a framework for mutually beneficial relations and co-operation between the countries of Southeast Asia on the one hand and the big powers on the other.

Indonesia-Malaysia Bilateral Relations

Jusuf WANANDI

INTRODUCTION

The purpose of this paper is to assess the relationship that has developed between Indonesia and Malaysia since the termination of Indonesia's confrontation against Malaysia (and Singapore) in 1966. The question to ask is whether over the past two decades the objectives of normalising the relations have been achieved. If the answer is positive, the subsequent question is what should be the objectives of promoting the relationship over the coming years.

Bilateral relations between Indonesia and Malaysia is often referred to in both countries as being of a "special" nature, because it is perceived to be based on Malay ethnicity and Islam in addition to geographic proximity. However, such perception should not be taken for granted and it is necessary to examine whether those perceptions are correct and what the consequences would be for the bilateral relationship if the above assumptions are not valid.

In an effort to enhance the two countries' understanding of each other, it should also be useful to compare their experiences in economic and political development. This effort appears to be necessitated by the changing environment in both countries, particularly as the younger generation takes over the national leadership in the respective countries. This new generation, unlike the incumbent leaders who have nurtured the existing close relationship, may not have the strong emotional motives to support such a close bilateral relationship.

SIMILARITIES AND DIFFERENCES BETWEEN INDONESIA AND MALAYSIA

Indonesia and Malaysia are generally perceived in both countries as two similar countries and peoples and are therefore expected to have similar views on various issues and developments. In fact, they are two sovereign countries that consequently make decisions primarily in accordance with their own national interests. Nonetheless, a thorough examination would reveal that there exist important differences as well as similarities between the two countries.

Similarities

First, history reveals that both peoples not only have the same ethnic and common geographic origins, but also have had similar experiences with and have been affected by influences from Hindu, Buddhist, Islamic and, later, European cultures. With the advent of colonialism both countries' histories took their respective course until both gained their respective independence in the middle of the 20th century. Following the difficult years of confrontation, the two countries finally came to their present close co-operation, bilaterally as well as within the framework of ASEAN.

Efforts to develop close ties between the two countries at the end of World War II led by some leaders in Indonesia who were involved in the Committee for the Preparation of Indonesian independence, Mohammad Hatta among others, to suggesting that independent Indonesia should exclude West Irian but should include Malaya and Singapore. There was a plan for Soekarno and Hatta to discuss the matter with Malayan leaders on their way back from their meeting with the Japanese Commander-in-Chief for South-East Asia in Dalat (Vietnam). But history took a different course, meeting with the Malayan leaders did not take place, and soon Indonesia proclaimed its independence on August 17 1945, without including Malaya and Singapore.

While it is important to understand the close ties in the past -- which also reveal differences -- it is more important to look into the future as the two countries are bound to continue to be close neighbours facing common threats and as such need to formulate a common strategy, either bilaterally or in the ASEAN framework, in order to maintain peace and stability in South-East Asia.

Both, being developing countries, will have a role to play in developing

economic co-operation with the industrialised countries and among the developing countries themselves. At the present stage of development, similarities of interest will easily develop into closer co-operation within the framework of ASEAN economic co-operation, and in developing co-operation with the industrialised countries in the Asia Pacific region.

The two countries also exhibit similar national and social dynamics. Nationalism, for example, is an important factor in their domestic political developments. Islam is another important factor of social dynamics for both with different impacts and consequences on the two societies. Indonesia and Malaysia also face similar problems of economic development such as on the questions of equity, modernisation and internationalisation, some of which have been dealt with in a similar fashion while others have been solved differently.

Differences

Besides similarities, there are also differences, even great differences, between Indonesia and Malaysia. In certain cases the two countries have adopted different solutions to similar problems. This should not be surprising since both are sovereign countries that have the right to adopt their own policies. This certainly does not mean that the two countries have not been influenced by the similar situations in which they are in but ultimately history, political system, social development and government leadership determine their individual policy choices.

An objective difference between the two countries is their size: Indonesia has a population of over 170 million while Malaysia only has 17 million. There is also a great difference in the diversity of the two nations. Indonesia is by far more diverse, but differences seem to be more deeply felt in Malaysia.

Another difference is that in the level of economic development. Malaysia already has a per capita GNP of over US\$2,000 while Indonesia's is still about US\$600. Although Indonesia has no less potentials, particularly in natural resources, it is likely that owing to its size it will remain behind Malaysia for several decades to come.

Differences in colonial history and modern nationalism have also brought about firstly, differences in national ideology. "Unity in diversity" is the essence of Indonesia's Pancasila, whereas Malaysia stresses on Malay primacy

in its "rukun negara."

Furthermore, ideological differences are also reflected in both countries' political systems. In Indonesia, party membership and objectives do not relate to racial or ethnic background, whereas in Malaysia the biggest and strongest party, UMNO, represents only the Malays, while the MCA, Gerakan and the DAP are basically Chinese and the MIC Indian.

Barisan Nasional has been set up to offset racial and ethnic differences that characterise the Malaysian party system. However, Barisan Nasional has not as yet functioned effectively in counterbalancing racial differences in the party system, largely because the necessary confidence among the leadership of the various parties is still lacking.

In Indonesia it is the Armed Forces (ABRI) that plays a prominent political role, because the existing party system has never been able to overcome personal or primordial motives, be it religion or ethnicity or regional sentiments. Therefore, the Indonesian political parties have not been able to organise and develop themselves into modern political parties, except the PKI (Indonesian Communist Party) until it was banned following the 1965 attempted coup. Golkar, which is now the biggest party, still shares power with ABRI and KORPRI (the bureaucracy). Indonesia has overcome problems stemming from ideologies like communism and religion because history has taught the nation to reject political ideologies other than Pancasila. The other ideologies are seen to cause disunity and instability.

Islam, being the religion of 85 per cent of the Indonesian population, has undoubtedly played an important role in Indonesia's political history, but it also has motivated certain groups to strive for Islam to become the national ideology. Attempts were even made through armed rebellion as was the case with the DI/TII insurgencies between 1947 and 1964 in West Java and South Sulawesi, as well as through constitutional and political actions as in the Constituent Assembly of 1958-1959 and in the Provisional People's Consultative Assembly during the 1966-1968 sessions. These attempts failed because the majority of the Indonesian people rejected an Islamic state. In fact, national consensus can only be allied around Pancasila which dictates that Indonesia is neither a secular nor a religious state, but one where religious beliefs are highly valued.

Most Indonesian moslems now see *dakwah* and other social and cultural activities, rather than political activities, as their main mission. New ideas have

also developed among young Moslem thinkers. They encompass the view that Islam is not a political but a cultural phenomenon, and that accepting Pancasila as the foundation and ideology of the Indonesian state is necessary to maintain national unity (Abdurrahman Wahid). Others see their engagement in socio-political endeavours with the aim of promoting democracy, human rights and the rule of law without the need for an Islam based party, which is seen as an inheritance of Dutch colonialism. (Nurcholish Madjid and such young Muhammadiyah leaders as Amin Rais). There are also young Islamic thinkers who prefer to strive for the fulfillment of basic human needs of the poor people who are mostly moslems (Adi Sasono).

Although no more than 50 per cent of Malaysia's population are Moslems, Islam is also an important political and social factor since it is the religion of the politically dominant Malays. It is the official state religion.

The problem for UMNO to day is how to incorporate Islam which has been adopted by the competing Partai Islam as its sole ideology and objective. Now UMNO faces the challenge of combining nationalism and development with Islam. Indonesia went through a similar development and has reached a consensus by adopting Pancasila, in which belief in the one God constitutes the first principle, and by maintaining a ministry for religious affairs to implement that principle. The development of new ideas by Islamic scholars and leaders in Indonesia, in which Islam is seen as a cultural phenomenon, or as an idea that aims at democracy and human rights, or as one that motivates endeavours to meet people's basic human needs, indicates that efforts to combine Islam with nationalism and development are continuously taking place.

In Malaysia the importance of racial identity in political development is such that political parties are based on it. However, Malaysia will face the problem of how to go beyond racial group interest and identity in the future. Malaysia will always face the problems of national unity if racial identity continues to be given such a prominent place in the political system. As a result of economic development, society may become more complex and the younger generation may demand for a more open and participating political system based on equality and common goals and they might no longer see the validity of a racially based political system. Political development in Malaysia appears to require the Chinese and Indians to become Malaysians in the first place while maintaining some of their cultural values and identities which can enrich Malaysia. The Malays should also have the courage to share power with the Malaysian Chinese and Indians, but essentially it is first of all the minorities who have to show loyalty to the country and nation. In the long run the objec-

tive of nation building should be achieved through a racially mixed education. However, the more immediate problem is the development of mutual confidence among leaders of the three most important ethnic groups. The Barisan Nasional leadership should be made effective to serve as an inter-ethnic deliberation forum to reach a consensus on problems and sensitive issues concerning their respective racial group.

In Indonesia, national unity also was a major problem throughout the first twenty years of turmoil after independence. Nevertheless it remains an important task to consolidate the achieved unity by paying greater attention to equitable distribution of development in general and to involving all regions, particularly the eastern part of the country. Problems concerning the Melanesian minority in Irian Jaya and East Timor certainly remain to be solved, but this is mainly a matter of time.

In the future, Indonesia's most important problem in political development will consist of how to maintain a harmonious relationship between the civilian and ABRI younger generations as the country faces the demand for a more open political system. Acceptance of ABRI's continued political role will depend upon ABRI's capability to adapt to the new realities that continue to unfold in the process of political, economic and social developments. So far, ABRI has proved that it is capable to do so. For example, in the 1987 General Elections ABRI adopted an equidistant policy with respect to all contesting political organisations, and gained respect and popularity for having behaved justly and impartially.

In matters concerning succession of the national leadership Malaysia is ahead of Indonesia. Malaysia has had four Prime Ministers in a row without any disturbances. In the case of Indonesia the 1965-1967 process of change from President Soekarno to President Soeharto was a traumatic one. It is this trauma that has made the Indonesians become more prudent and perhaps also more cautious in matters concerning political succession. They are no longer willing to risk national unity and development with another traumatic succession. Neither are they willing to disrupt the system and the institutions that have been developed under the New Order, as every important social group has a stake in the existing system and its achievements. Leadership in all fields is already being transferred to the younger generation, leaving generational change in the national leadership (presidency) to be the only remaining one. Therefore, it is expected that the succession will take place peacefully and in an orderly fashion. However, everybody will be satisfied only when a smooth transition has actually taken place.

In view of the dominance of the Malays in politics, their unity is of great importance, and therefore, the split in UMNO that has unfolded since 1987, has caused some concern, including in Indonesia. However, the split appears to be a natural consequence of the party's growth: While in the beginning UMNO was an elitist party where its leaders were well acquainted with each other, it has grown over the years into a large party and has undergone a democratisation process. This has led to greater participation by a large number of leaders.

INDONESIA-MALAYSIA CO-OPERATION IN THE FUTURE

Economic Co-operation

Provided that there is sufficient commitment in both Indonesia and Malaysia to use whatever opportunities there are to strengthen their bilateral ties, co-operation could always be improved in trade and industry. Trade has developed only very slowly (about US\$200 million in 1987 both ways). This requires further studies to examine new opportunities and new venues including the dismantling of existing barriers for mutual benefit. Being producers of the same commodities (tin, rubber, cocoa, oil, LNG and wood), both countries tend to compete in the world market, while, in fact, both should join hands and develop a common marketing strategy for those commodities, processed raw materials and manufactured products, with a view to jointly penetrating world markets.

In industry, complementarity could be developed further. To do so, both should be willing to lift the artificial barriers and to design market-conforming incentives. The latter could be done by encouraging investors from both countries to set up joint ventures. In tourism, the governments of the two countries have agreed to promote bilateral co-operation, but a lot remains to be done to jointly exploit the available opportunities. Those various areas for co-operation, especially in world market penetration, could be promoted bilaterally or within the ASEAN framework. However, it is important that a realistic calculation be made before a joint project is launched.

Co-operation in Technology, Education, Language Research and Culture

Although co-operation has been fostered in the area of language, education and culture, it appears that the implementation has been too narrowly

focused and very low keyed. Technology is one area of co-operation that remains to be developed. The possibility of co-operation in high technology could be explored. Arrangements for complementarity and mutually beneficial co-operation in aviation, telecommunication and electronics also could be jointly considered.

Co-operation in education started as early as in 1967, right after confrontation ended, with Indonesian teachers and lecturers going to Malaysia to teach, and Malaysian students coming to Indonesia to study. But the number of Malaysian students studying in Indonesia, and the number of Indonesian students studying in Malaysia are hardly significant as compared to those studying in western countries, particularly in the United States and Australia.

As regards co-operation in language development the Joint Commission for Language Development has undoubtedly been valuable. It appears, however, that activities will need to be increased to offset the ever widening gap. It is also felt that too little has been done in cultural co-operation. Cultural relations are largely taken for granted, perhaps because of the perceived strong cultural affinity that exists. In fact, cultural affinities should not be overemphasised since the two cultures are quite different in the sense that the Indonesian culture comprises much greater diversities. Consequently, it is important that cultural co-operation be increased. Media exchange could play an important role in this mutual endeavour. This could also enhance mutual understanding among the people and the leaders. A regular and frequent exchange of visits among both countries' journalists may also rectify the deficiency in both countries' news coverage about each other that relies heavily on international news agencies.

Social and Political Co-operation

A study of each other's political development should be undertaken to compare both countries' political systems. In fact, the two countries can learn from each other on the ways their political systems respond to challenges facing them. For, in the last instance, Indonesia and Malaysia are faced with similar challenges, stemming from rapid changes brought about by the successful economic development, by the rapidly growing number of the educated youth and by the inevitable exposure of both societies to the international world. It is due to those developments that there has been a growing pressure from the younger generation in both countries for a more open political system. The challenges facing both countries' governing elites in the coming

years will essentially consist of how to continuously strike a proper balance between stability and political development.

Relations between Barisan Nasional and Golkar and the two other political parties in Indonesia should be increased. Their leaders should meet more regularly through exchanges of visits, regular meetings, and through more frequent consultations in the various international fora such as the Asian Parliamentary Union and the International Parliamentary Union.

Indonesia and Malaysia could also develop closer co-operation, bilaterally or within the framework of ASEAN, in the implementation of their foreign policy, in which similarities are numerous. Dialogues between both countries' diplomats and officials that have frequently taken place, could be intensified so as to involve officials in charge of economic affairs who have met each other less frequently. The two countries could improve co-ordination in their international economic policies in relations between ASEAN and the industrialised countries.

Those policy dialogues should be well prepared and it is important that differences between the two systems be taken into account. It should be well understood, for example, that cabinet ministers in Malaysia are politicians who enjoy solid political support within the party and among the people in their respective constituencies and that consequently they are not necessarily experts in the affairs of their ministries, but that they can presumably rely on the expertise of their respective deputy minister or the permanent secretary. In the case of Indonesia, her economic ministers are mostly technocrats.

Defence and Security Co-operation

Initially confined to the Joint Border Committee (JBC) to deal with communist insurgents in the Sabah and Serawak border areas, co-operation in the defence and security realm between the two countries has been successful and fairly well developed.

Defence and security co-operation now includes intelligence exchange, joint exercises, exchanges of officers to attend courses in military educational institutions, exchanges of information in arms acquisition and a limited arrangement on the complementarity of both countries' arms industry. Co-operation could also be promoted in the specific field of arms procurement or in arms industry. Co-operation in procurement could be developed further

with the objective of increasing efficiency. A triangular defence and security co-operation between Indonesia, Malaysia and Singapore should be considered in view to guarding the SLOCs of the three countries.

Malaysia's relations with ABRI (Indonesian Armed Forces) and the Indonesian Department of Defence and Security should take into account ABRI's role in socio-political matters. This implies that relations with ABRI should not be confined to defence and security matters only, but should also include social and political matters.

CONCLUDING REMARKS

It is obvious from the above analysis, that while history and geopolitics have indeed brought Indonesia and Malaysia to their present close relationship, the relationship should not be taken for granted. This relationship is strategically important as the two countries share the same perception of threat and pursue parallel foreign policies. But the real obstacles that exist in the relationship should also be recognised and ways to overcome them should be sought. Differences between two sovereign countries such as Indonesia and Malaysia will always exist however close they may be. Efforts should be made to improve understanding of the differences, and to overcome them swiftly whenever those differences begin to affect the relationship. Perceptions and accepted notions of the great similarities between the two should be continuously re-examined so as not to be overtaken by developments and to lose thus their relevance to become mere myths.

ASEAN is important to the relationship between Indonesia and Malaysia, and together with Singapore, they should become the spearhead of the regional association. The co-operation between the three countries will very much determine the course that ASEAN will take in the future as well as the accepted modes of co-operation. It is also important for Indonesia and Malaysia to co-operate in the various international fora, so as to defend the interests of ASEAN, the South-East Asian region, and the interests of other developing countries. This is the more so as international relations are undergoing important and rapid changes.

Indonesia-Malaysia bilateral relations are also important for both to learn from each other's experiences in the handling of domestic political matters and on the changes that have taken place in both societies. This could certainly contribute to the development of the two countries and peoples.

Analysing the Colonial Myth

The Myth of the Lazy Native: The Image of the Javanese, Malays and the Filipinos in Colonial Capitalism

by S.H. Alatas. Jakarta: LP3ES, 1987, 388 pp. (Indonesian edition). This review article by Budiawan is translated from *Kompas*, 29 May 1988.

Social sciences are indeed not value-free. Their findings, consciously or not, are always influenced by a tint of a certain ideology. On the other hand the results of their findings have confirmed the ideology one is trying to perpetuate.

The colour of the ideology which is hidden behind those findings may be unfolded by virtue of an approach based on the sociology of knowledge, which has among other things been developed by "Karl Mannheim." On the basis of this approach the objectivity of social sciences is highlighted through their functional aspects. And those functional aspects may be comprehended by putting the findings in their sociological and historical contexts.

S.H. Alatas, whom we know among other things by his book entitled *Sosiologi Korupsi* (the Sociology of Corruption), using a sociological approach in his attempt to analyse the myth with regard to the laziness of the Javanese, Malays and Filipinos. Through a quite extensive and comprehensive bibliographical study, he arrives at the conclusion that the myth was originally created by European adventurers, missionaries and officials, who came to this region, and was thereafter given a "scientific colour" by some scientists. It is through this "scientification" that this view has been widely known as though it were taken for granted. So strong is this view that it becomes a myth.

The first analysis is made by comparing the sociological condition of the three ethnic groups during the periods before and after the advent of the Europeans. Before the advent of the Europeans, economic activities of the indigenous people of Southcast Asia were strongly coloured by quite dynamic regional and international trade. This may be verified by the discovery of ancient trade routes stretching out from this region to other regions such as, among other things South Asia, the Middle East even as far as East Africa.

On the basis of such an economic activity the formation of the social fabric of the South-east Asian people was marked by the existence of groups of traders possessing quite strong positions, who as a rule lived in littoral towns. However, after the arrival of the Europeans, due to a variety of ways and means, through either diplomacy or by force, were able to defeat the indigenous authorities who were *nota bene* also traders, and trade activities shifted towards a monopoly by the aliens.

Meanwhile as an endeavour for survival economic activities of the indigenous people began to move to the hinterland and were based on agriculture. Since they served as an endeavour for survival, these activities were more subsistent in nature, while the existence of the groups of traders began to fade away.

MONOPOLY

In line with the development of European history, which around the 18-19th century was marked by the emergence of the industrialisation process, economic activities of the Europeans in Southeast Asia started to expand which were not limited to the monopoly of trade alone but also entered the hinterland to dominate the exploitation of raw materials such as mining and agricultural products. It was in the effort to expand their capital that they needed the involvement of the indigenous labour force which they obtained by using force.

The condition of the work and the inadequate wages which did not commensurate with the work load have caused negative reactions amongst the workers in those foreign plantations. Those negative reactions were manifested in the workers' behaviour, varying from reluctance to work up to the level of extreme actions, such as rebellions, sabotages and strikes. It was those reactions that were labelled by the Europeans as indigenous people's laziness. And they associated their assessment with the geographical condition, which they con-

tended being conducive to indigenous "laziness." In other words, they judged that "laziness" was really a part of the indigenous culture.

It was under that pretext that they called in Chinese and Indian workers. The fact that these foreign workers did not complain much, let alone launched protests against their employers, made them judge those workers as being diligent people. And taking this judgement as a point of departure the colonial government adopted the policy of racial discrimination where the indigenous population was placed at the lowest stratum.

And by putting it back to its historical and sociological context it appears that the myth of lazy natives emerged as an attempt to perpetuate the colonial ideology. Conspicuously the criterion of being "lazy or diligent" was based on the colonial interest, not on the basis as to how the indigenous people attempt to subsist. Because, it was on the basis of that criterion that they could avoid the work they loathed which was, however, of vital importance to them. Hence it is not surprising that a quite rhetorical question was raised amongst the indigenous nationalists: who exactly were the lazy ones, those refusing to do the hard work with low pay, or those who forced those hard labour to others?

Accordingly, based on sociological approach, the author is able to unfold the latent myth of the lazy native. Methodologically this approach could be accounted for. However, without being critical one may be trapped in excessive self-justification, so as to blur the true social reality. And the writer is aware of this fact. Hence it is not an exaggeration if it is contended that the idea of the indigenisation of social sciences is not a Utopia.

Analysing Indonesian Islamic Thoughts

Desecularisation of Thoughts (in Indonesian: *Desekularisasi Pemikiran*) by A.M. Saefuddin et al. Bandung: Mizan, 1987, 323 pp. This review article is written by Suwardi, staff of CSIS.

The author of this book is a doctor in agronomics and concurrently Chairman of the Educational Foundation of Ibn Khaldun, Bogor. The introduction is written by Jujun Suparjan Suriasumantri a doctor in educational planning.

This book seems to be intended to substitute science with religious thoughts, or to be more exact, to put science back to its origin: religion. This discussion is interesting, since either science or religious thoughts has different ways of operations with regard to its research objective, its reference or interest etc. Both science and religious thoughts are complex in nature, have many aspects, dimensions and visions, which up till now are still developing in line with the development of man and humanity living in an everchanging era.

That attempt is apparently a further elaboration of the introduction entitled "Looking for Alternatives of New Science." It is pointed out here that the truth brought forward by science is unsatisfactory, since its verity is pragmatic, probabilistic, correspondentive in nature and the like. It appears that science and its application (technology) cannot solve every human problem, and will have a negative impact such as, cultural dehumanisation and moral degeneration. That confusion is assessed to be originating from the material verity of science itself. Philosophically it is closely related to the essence of science, especially as far as the ontological, epistemological and axiolo-

gical principles of science are concerned. In brief, the verity of science is partial, limited and relative in nature. It also points out that the confusion is also due to the segmentalisation of knowledge, particularly science; religion and arts; or because science has no moral control over its application which also includes the scope of its study.

Meanwhile Saefuddin opines that the development of science which has emerged since Renaissance has really pushed aside religious life. Science sets itself free from religion. It is this science which has thereafter rapidly developed, changing all aspects and walks of both private and public life. The intellectual fatigue and obsession prevailing lately amongst scholars he assesses as being the consequences of science which is separated from religion. Based on this view, science is considered as being secular. Hence in line with Jujun's idea, Saefuddin puts forward religion as an alternative of the *new science*.

In order to elaborate his thoughts, Saefuddin divides his book into three chapters. Chapter I is entitled: "Philosophy and Science." This chapter attempts to place the new alternative of science (religion) in the constellation of philosophy and science. Religion becomes both the material object (the material to be surveyed) and the formal object (perspective of the survey) of philosophy and the new science concerned. Accordingly there emerge new ontology, axiology and scientific method.

In Chapter II, steps to be taken on the operationalisation of the new science are pointed out. The educational facilities from Kindergarten to the University level are assessed as being strategic means for the operation of the new science. The substance to be given to the learning process should no longer be centred around the separation of science from religion, but both should become one integral unity as a new dimension of science. What is to exist is only one science, that is, Divine Science, which prescribes absolute, complete truth.

Chapter III constitutes the principal frame of reference of the thoughts which have indirectly been practised in the first chapter. The fact that it is presented in the third chapter seems to imply that it serves to function as the legitimacy of the frame of thoughts of the whole book. Hence the pattern of thoughts in the first chapter is undoubtedly in harmony with, being in the same spirit as and in line with the frame of reference presented in chapter three.

For the Indonesian society who in this Fifth Pelita (the Fifth Five-Year Development Plan) is making efforts to consolidate the foundation of the take-off stage, in the ideological, political, economic, cultural fields and the like, this interesting book is worth studying. Its attractiveness especially lies in its substance, namely science. For people living in the post take-off stage, the role of science and technology seems likely to be very substantial and decisive. Such a role can only be realised if during the period of consolidating the foundational framework of the take-off stage, everything related to science really has a firm, solid, strong framework and belongs to the whole nation. It is only by virtue of such a framework of the take-off stage that science and technology may function to promote and improve the intellectual life of the society and the nation so as to enable it to develop itself. Given such a scale of thoughts, some points related to that book need to be specified.

Saefuddin opines that once in the historical past an era of the downfall of modern man occurred. The birth of humanism which claimed the way of man's thinking, dragged man to the formalism of life. The birth of the force of thinking and rational power, he contends, made man try to stand on his own feet. Man tried to use his freedom. Man tried to free himself from the bonds coming from outside of his own self, including the bond of religion. In other words, man wanted to base his existence on the new awareness of his own self, his society and world. Renaissance brought with it a

new atmosphere to live and to life itself, so that a new human being emerged, with new awareness and possibilities.

That Renaissance offered a new humanism seems not to be difficult to understand. The disappearance of the *golden age* of religious thoughts on science, philosophy and knowledge, accordingly, is really a mere process of man's history. The *golden age* was not the peak of the history of religious thoughts, neither was it the peak of the history of either man's or mankind's thoughts. It was merely one phase of the history of mankind, including that of religious thoughts. Longing for the re-emergence of such an era, at the time when science and philosophy still had their source in religion as was the case prior to the renaissance era, is precisely a regressive act. Such an act is exactly not conducive to and does not promote the development of man who makes headway in line with the progress of the era, including religious thoughts and science. On a large scale such thoughts are exactly a setback and moves away from advancement and development.

In addition, the writer contends that people are not satisfied with the verity of science which is relative, pragmatic, probabilistic etc. in nature. In fact, the verity of science need not be debated since it is inherent in the limited nature of man. The limited nature of truth is in fact a reflection of the limited nature of the methodology of science; and that constitutes none other than a reflection of the limited nature of a human being. Accordingly science has indeed real human character, and is not divine in nature. Since the verity of science is limited in nature, it is not surprising, therefore, that in science one knows various theories of truth. In this regard there are, for example, the correspondence theory of truth, coherence theory of truth, or pragmatic theory of truth.¹ Discarding and leaving human truth

¹Horner, Stanley, and Hunt, Thomas C., *Invitation of Philosophy*, California: Wardsworth, 1968, pp. 57-63.

aside in order to look for truth which is not human (divine perhaps), is indeed also the right of every person. However, such an attitude does not in principle change human truth itself. Furthermore, such an attitude may give rise to worries if absolute truth, which is in fact attributed to the Absolute Creator, is claimed to be the truth that can be attained by human beings, particularly by virtue of the new knowledge concerned.

On the other hand it is also contended that it is necessary to relate science, be it ontology, epistemology or axiology back to Allah as the Centre and the Source of everything. What is implied in that attempt is to obtain the quality of truth. The truth that emerges is theological truth since theological approach is used. That truth is not identical with divine truth. Divine Truth is epistemologically only identical with Allah Himself. Therefore, the truth that is obtained through the efforts to relate science back to Allah, is not absolute in nature. Absolutising limited truth is similar to absolutising something which is not absolute. Such an act is essentially none other than attributing Divine nature to something which is not God. In Hegel's terminology, it is called a process of idolatry, since what is absolutised is basically not absolute in nature, and what is considered as being Divine is not Divine. If this pattern is to be continued it will only end in dissatisfaction, disappointment, impossibility or absurdity. In social life such type of thinking may emerge as a *religious theocratic* movement, which used to develop and flourish during the age before Renaissance.

The limited nature of human beings is in fact not in conflict with the nature of man being open to God the Unlimited. Apparently seen from the religious viewpoint this (modesty, by accepting oneself as such) exactly constitute a *prerequisite* to be able to *catch* Him Who is Unlimited. Hence, the existence of truth which is limited to science and its methodology (and eventually to man) *precisely* constitutes the appropriate disposition in the attempt to be conscious of The Unlimited. Fur-

ther, it is the limited nature of scientific truth that urges man to continuously seek more adequate, whole and perfect truth. Therefore, it is not surprising if one opines that science is a way of life to obtain truth and perfection, aside from religion, philosophy and art in particular and literature in general.²

Aside from that, another interesting point should be mentioned. If there are today various specialisation of science, Saefuddin, on the other hand, just tries to unify those various sciences to the situation before the Renaissance. The return of science to its *base* namely religion, is considered by Saefuddin as the ideal target to be attained in order to enable man to face the challenges and demands of science and technology. One might say that such an attempt is as it were to *criticise the birth of science*, and further also its growth and development until now. The question as to whether this can be labelled as "purifying" science, remains to be seen. It appears however, that such an attempt is not in line with the law of growth and relationship of science itself. The attempt to unify its methodology as a consequence, is also unlike and not in line with the tendency of scientists who opt for a multi-disciplinary or inter-disciplinary approach.³

²A Teeuw, Eulogy for Dr. I. Kuntoro Wirjomartono, *Basis*, No. XXXVI (December 1987), p. 442.

³There is actually a difference between multi-disciplinary and inter-disciplinary approach. The multi-disciplinary approach constitutes a co-operation among independent disciplines. Whereas the inter-disciplinary approach constitutes rather the involvement of theories which are able to solve fundamental problems of quite different sciences. In this case, the inter-disciplinary sciences such as, for example the *theory of information*, tend to develop into independent sciences, though they may still serve many other sciences (see Beerling, Kwee, Mooy, van Peursen), *Pengantar Filsafat Ilmu* (Introduction of the Philosophy of Science, Yogyakarta: Tiara Wacana, 1986).

Meanwhile the scientific method suggested also does not refer to the scientific method which is referred to by Jujun as logico-hypothetico verifacative.⁴

It is also pointed out that the condition which is conducive to the return of science to religion as its source, is the necessity for the desecularisation of science. Science has to abandon its secular nature. The desecularisation of science calls for the *desecularisation of thoughts*. According to Saefuddin such a condition is greatly needed as the basis of rendering religiousness to everything, including cultural science and technology. As the consequence of desecularisation of thoughts, new epistemology, new ontology and axiology are required. Either the new ontology, epistemology or axiology, Saefuddin opines, should be returned to Allah as the only source of reality that exists and which is perfect. There will no longer be dichotomy between science and religion with these new ontology, epistemology and axiology. Both will be united towards God. With such a condition man no longer need to go through violent shocks as the consequence of the emergence and development of both science and technology.

Those shocks experienced by man, in fact, are not merely due to the specific external factors such as, ontology, epistemology or axiology of science. The presence of those shocks, is in fact due to the respective internal factors of human subjects who are religious, scientists, technologists, and live a social and state life. Hence a more crucial problem is the question as to how to step up the capacity of those subjects in enlivening their existence and life in an era which is continuously flooded by the products of science and technology.

Either the receptive, absorptive and adaptive capacity or the reflection and anticipation with regard to all emerging phenomena and which may emerge in society, basically con-

stitute an array of traits to be acquired, cultivated and made mature of within man. Accordingly, in the light of this approach, the implication, which is willy-nilly to be studied and observed, is how to form and prepare a human quality that is capable of facing its era. Hence education in the broadest possible sense constitutes the sole answer which is able to anticipate and overcome Saefuddin's problem. It is in the education that man is educated and trained in order to acquire a quality which is adequately adjusted to the demands and challenges of the era, including the challenges and demands of development and of scientific and technological progress.

The situation faced by Saefuddin is that of development and the advancement of science and technology which are actually inherent in the growth and development of the era itself. In the light of religious thoughts, it appears that it constitutes a challenge which is difficult to avoid. In the face of such a situation the orientation of the religious thoughts of the Indonesian nation should not chain itself and let it be terrorised and dismantled. Our religious thoughts should be sharpened so as to enable the Indonesian nation to analyse and equip itself in order to face all those challenges and demands. In this respect these religious thoughts have to face two kinds of attitudes, namely a realistic and unrealistic attitude. An unrealistic attitude will regard all challenges and developments of science/technology as being unreal. If it is real, it has to be accepted and understood in compliance with the subject's will and not according to what the fact is. Hence the nature and essence of the object have to comply with the will of the subject, or have to be changed in such a manner so as to accord with the will of the subject.

Unlike the unrealistic attitude the realistic attitude attempts to seek the message and meaning of the tenet of religion in his era.⁵ Accord-

⁴Jujun S. Suriasumantri, *Filsafat Ilmu* (Jakarta: Sinar Harapan, 1982), pp. 119-140.

⁵The terminologies which expound this matter are for example: *reactualisation of doctrine*, the concept of *contextualism*, thoughts

ding to this attitude the tenet of religion is meant to serve mankind. It is not regarded as being static, dogmatic, rigid and ossified in nature. The tenet of religion has a plastic and elastic character. Religion not only addressed and talked to people in the past (at the time of birth of religions), but it also speaks to people in this age. In other words, man is always relevant to religion in any situation, and reversely the understanding of religion will become relevant to people.

on religion having a *complementary* function, and the like. Such thoughts may be noted, for example, in the address of the Minister for Religious Affairs at the seminar "Pembangunan Hukum dan Perkembangan Fiqh di Indonesia" (The Development of Law and Development of Fiqh in Indonesia) on February 4th 1985, in *Pelita* daily newspaper, 16th February 1985, or in the Opening of the Meeting of the Supreme Court and Heads of Higher Courts throughout Indonesia, on 21st March, *Pelita*, 23rd March 1985; see also Abdurrahman Wahid's article: Masa Islam Dalam Kehidupan Bernegara dan Berbangsa (The Islamic Mass in the Life of State and Nationhood), in *Prisma*, No. Extra, 1984, Year XIII.

It is this realistic option that has to be put forward, if religion is to face the challenges and demands of the era (including the development and advancement of science): In view of the absence of this realistic attitude of thoughts, this book is actually more inclined towards the unrealistic attitude, which will lead to a deadlock. It is in this sense that the book may be said to be inconducive to the enhancement of the foundation of the take-off stage of development particularly in the field of science. Although the impact of the development and progress of science on religious life has indeed been properly and appropriately discussed, its solution however, has not as yet reached a comprehensive target.

Nevertheless, this book should also be read by scientists and religious prominents, not to look for the solution suggested, but to see the dimension of the problem faced by man (particularly the religious ones) with regard to the development of science and technology. If one acknowledges that science and technology will make headway and continue to develop, and time will bring about changes, man will be led to reconsider realistically his religious thoughts. Religion, including religious thoughts, appears also to be inseparable from the mechanism of *critic*, if religion is still to be significant to human beings.

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